NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

April 24, 1992

Eligible Obligations/
loans/secondary market

David M. Schram
President/CEO
Northwest Telco
Credit Union
2821 Hewitt Avenue
Everett, WA 98201-3890

Re: Eligible Obligations
(Your Letter of March 20, 1992)

Dear Mr. Schram:

You requested a legal opinion regarding the NCUA eligible obligation regulation. 12 C.F.R. §701.23. This regulation applies only to federal credit unions ("FCUs"). Northwest Telco Credit Union ("NWTCU") is a federally insured, state-chartered credit union ("FISCU"). Section 701.23 of the NCUA Rules and Regulations does not apply to FISCUs. Section 741.4 of the NCUA Rules and Regulations does apply to the purchase and acquisition of loans by FISCUs, but does not apply to purchases of real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market. 12 C.F.R. §741.4(b)(1). You stated in your letter that the Washington State Supervisor, Division of Savings and Loan, has approved your program to act as a seller/servicer of real estate secured loans for the secondary market. We would advise you to follow the requirements and guidance of your primary regulator.

Each FCU selling loans to NWTCU has the responsibility to ensure that it complies with the FCU Act and NCUA Rules and Regulations. FCUs must originate real estate secured loans in accordance with NCUA requirements. See 12 U.S.C. §1757(5)(A), 12 C.F.R. §701.21(g), NCUA Letter to Credit Unions Nos. 124 (June 1991), and 125 (June 1991) (enclosed). FCUs may sell real estate secured loans to NWTCU if such sales meet the requirements of the eligible obligation regulation. 12 C.F.R. §701.23. Sales of loans are allowable

FOIA Vol. I, C, 6, Vol. I, 16, Vol. V, 14, 1

if made within the limitations of the written sale policies of the board of director's of the FCU, the board of directors or investment committee approves the sale, and a written agreement and a schedule of the eligible obligations covered by the agreement are retained in the seller's office. 12 C.F.R. §701.23(c). As long as the requirements of Section 701.23 are met, FCUs may sell real estate secured loans to NWTCU unless the Region has safety and soundness concerns.

In addition, you state that NWTCU has formed a credit union service organization ("CUSO"), The Snohomish County CUSO, to provide other credit unions with real estate loan processing and servicing. It is unclear whether NWTCU is the only investor in this CUSO. Any FCU that invests in or loans money to a CUSO is subject to Section 701.27 of the NCUA Rules and Regulations. 12 C.F.R. §701.27. A copy of that regulation is enclosed for your review.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel

cc: Daniel Murphy,
Region VI Director

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Enclosures

(4) to purchase, hold, and dispose of property necessary or incidental to its operations;

(5) to make loans, the maturities of which shall not exceed twelve years except as otherwise provided herein, and extend lines of credit to its members, to other credit unions, and to credit union organizations and to participate with other credit unions, credit union organizations, or financial organizations in making loans to credit union members in accordance with the following:

(A) Loans to members shall be made in conformity with criteria established by the board of directors: *Provided, That—*

(i) a residential real estate loan on a one-to-four-family dwelling, including an individual cooperative unit, that is or will be the principal residence of a credit union member, and which is secured by a first lien upon such dwelling, and may have a maturity not exceeding thirty years or such other limits as shall be set by the National Credit Union Administration Board (except that a loan on an individual cooperative unit shall be adequately secured as defined by the Board), subject to the rules and regulations of the Board;

(ii) a loan to finance the purchase of a mobile home, which shall be secured by a first lien on such mobile home, to be used by the credit union member as his residence, a loan for the repair, alteration, or improvement of a residential dwelling which is the residence of a credit union member, or a second mortgage loan secured by a residential dwelling which is the residence of a credit union member, shall have a maturity not to exceed 15 years or any longer term which the Board may allow.

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

(iv) a loan or aggregate of loans to a director or member of the supervisory or credit committee of the credit union making the loan which exceeds $10,000 plus pledged shares, be approved by the board of directors;

(v) loans to other members for which directors or members of the supervisory or credit committee act as guarantor or endorser be approved by the board of directors when such loans standing alone or when added to any outstanding loan or loans of the guarantor or endorser exceeds $10,000;

(vi) the rate of interest may not exceed 15 per centum per annum on the unpaid balance inclusive of all finance charges, except that the Board may establish—

(I) after consultation with the appropriate committees of the Congress, the Department of Treasury, and the Federal financial institution regulatory agencies, an interest rate ceiling exceeding such 15 per centum per annum rate, for periods not to exceed 18 months, if it determines that money market interest rates have risen over the preceding six-month period and that prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth; and

(II) a higher interest rate ceiling for Agent members of the Central Liquidity Facility in carrying out the provisions of title III for such periods as the Board may authorize,

(vii) the taking, receiving, reserving, or charging of a rate of interest greater than is allowed by this paragraph, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back from the credit union taking or receiving the same, in an action in the nature of an action of debt, the entire amount of interest paid; but such action must be commenced within two years from the time the usurious collection was made;

(viii) a borrower may repay his loan, prior to maturity in whole or in part on any business day without penalty, except that on a first or second mortgage loan a Federal credit union may require that any partial prepayments (I) be made on the date monthly installments are due and (II) be in the amount of that part of one or more monthly installments which would be applicable to principal;

(ix) loans shall be paid or amortized in accordance with rules and regulations prescribed by the Board after taking into account the needs or conditions of the borrowers, the amounts and duration of the loans, the interests of the members and the credit unions, and such other factors as the Board deems relevant;

(x) loans must be approved by the credit committee or a loan officer, but no loan may be made to any member if, upon the making of that loan, the member would be indebted to the Federal

12 U.S.C. §1757(5)(A)

credit union upon loans made to him in an aggregate amount which would exceed 10 per centum of the credit union's unimpaired capital and surplus.

(B) A self-replenishing line of credit to a borrower may be established to a stated maximum amount on certain terms and conditions which may be different from the terms and conditions established for another borrower.

(C) Loans to other credit unions shall be approved by the board of directors.

(D) Loans to credit union organizations shall be approved by the board of directors and shall not exceed 1 per centum of the paid-in and unimpaired capital and surplus of the credit union. A credit union organization means any organization as determined by the Board, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve.

(E) Participation loans with other credit unions, credit union organizations, or financial organizations shall be in accordance with written policies of the board of directors. *Provided*, That a credit union which originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at least 10 per centum of the face amount of the loan.

(6) To receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian Tribal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of credit unions serving predominantly low-income members (as defined by the Board) payments, representing equity, on—(A) shares which may be issued at varying dividend rates; (B) share certificates which may be issued at varying dividend rates and maturities; and (C) share draft accounts authorized under Section 205(f); subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Board.

(7) To invest its funds (A) in loans exclusively to members; (B) in obligations of the United States of America, or securities fully guaranteed as to principal and interest thereby; (C) in accordance with rules and regulations prescribed by the Board, in loans to other credit unions in the total amount not exceeding 25 per centum of its paid-in and unimpaired capital and surplus; (D) in shares or accounts of savings and loan associations or mutual savings banks, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation; (E) in obligations issued by banks for cooperatives, Federal land banks, Federal intermediate credit banks, Federal home loan banks, the Federal Home Loan Bank Board, or any corporation designated in section [redacted] of Title 31 as a wholly owned Government corporation; or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Government National Mortgage Association; or in mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Section 305 or Section 306 of the Federal Home Loan Mortgage Corporation Act; or in obligations or other instruments or securities of the Student Loan Marketing Association; or in obligations, participations, securities, or other instruments of, or issued by, or fully guaranteed as to principal and interest by any other agency of the United States and a Federal credit union may issue and sell securities which are guaranteed pursuant to section 306(g) of the National Housing Act; (F) in participation certificates evidencing beneficial interests in obligations, or in the right to receive interest and principal collections therefrom, which obligations have been subjected by one or more Government agencies to a trust or trusts for which any executive department, agency, or instrumentality of the United States (or the head thereof) has been named to act as trustee; (G) in shares or deposits of any central credit union in which such investments are specifically authorized by the board of directors of the Federal credit union making the investment; (H) in shares, share certificates, or share deposits of federally insured credit unions; (I) in the shares, stocks, or obligations of any other organization, providing services which are associated with the routine operations of credit unions, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Board: *Provided, however*, That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this Act; (J) in the capital stock of the National Credit Union Central Liquidity Facility; and (K) investments in obligations of, or issued by, any State or political subdivision thereof (including any agency, corporation, or instrumentality of a State or political subdivision), except that no credit

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insurance or guarantee of, or with an advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either, may be made for the maturity and under the terms and conditions, including rate of interest, specified in the law, regulations or program under which the insurance, guarantee or commitment is provided.

(f) *20-Year Loans.* Notwithstanding the general 12-year maturity limit on loans to members, a Federal credit union may make loans with maturities of up to 20 years in the case of: (1) a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence and the loan is secured by a first lien on the mobile home, (2) a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower, and (3) a loan to finance the repair, alteration, or improvement of a residential dwelling which is the residence of the member-borrower.

(g) *Long-Term Mortgage Loans:*

(1) *Authority.* A Federal credit union may make residential real estate loans to members, with maturities of up to 40 years, or such longer period as may be permitted by the NCUA Board on a case-by-case basis, subject to the conditions of this Section (701.21(g)).

(2) *Statutory limits.* The loan shall be made on a one to four family dwelling that is or will be the principal residence of the member-borrower and the loan shall be secured by a perfected first lien in favor of the credit union on such dwelling (or a perfected first security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

(3) *Loan application.* The loan application shall be a completed standard Federal Housing Administration, Veterans Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association application form. In lieu of use of a standard application the Federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable Federal, state and local laws.

(4) *Security instrument and note.* The security instrument and note shall be executed on the most current version of the FHA, VA, FHLMC, FNMA, or FHLMC/FNMA Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that would be applicable to principal. In lieu of use of a standard security instrument and note, the Federal credit union may have a current attorney's opinion on file stating that the security instrument and note in use meet the requirements of applicable Federal, state and local laws.

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

(6) *Due-on-sale clauses:*

(i) Except as otherwise provided herein, the exercise of a due-on-sale clause by a Federal credit union is governed exclusively by Section 341 of Public Law 97-320 and by any regulations issued by the Federal Home Loan Bank Board implementing Section 341.

(ii) In the case of a contract involving a long-term (greater than twelve years), fixed rate first mortgage loan which was made or assumed, including a transfer of the liened property subject to the loan, during the period beginning on the date a state adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such state has rendered a decision (or if the highest court has not so decided, the date on which the next highest court has rendered a decision resulting in a final judgment if such decision applies statewide) prohibiting such exercise, and ending on October 15, 1982, a Federal credit union may exercise a due-on-sale clause in the case of a transfer which occurs on or after November 18, 1982, unless exercise of the due-on-sale clause would be based on any of the following:

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

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

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

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

701.21(g)

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

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

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

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

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

(h) *Member Business Loans*

(1) *Definitions.*

(i) "Member business loans" mean any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate, business investment property or venture, or agricultural purpose, except that the following shall not be considered member business loans for the purposes of this Section:

(A) A loan or loans fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence.

(B) A loan that is fully secured by shares in the credit union or deposits in other financial institutions.

(C) A loan meeting the general definition of "member business loans" under (i) above, and, made to a borrower or an associated member (as defined in (iii)), which, when added to other such loans to the borrower or associated member, is less than $25,000.

(D) A loan, the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by any agency of the Federal government or of a state or any of its political subdivisions.

(E) A loan granted by a corporate credit union operating under the provisions of Part 704 of these rules, to another credit union.

(ii) "Reserves" mean all reserves, including the Allowance for Loan Losses and undivided earnings or surplus.

(iii) "Associated Member" means any member with a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower.

(iv) "Immediate Family Member" means a spouse or other family member living in the same household.

(v) "Loan-to-value" (LTV) ratio means the quotient of the aggregate amount of all sums borrowed from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

(vi) "Construction or development loan" means a financing arrangement for the purpose of acquisition of property or rights to property, including land or structures, with the intent of conversion into income-producing property including residential housing for rental or sale, commercial, or industrial use, or a similar use.

(2) *Requirements.* Member business loans, as defined in Section 701.21(h)(1)(i), may be made by Federal credit unions only in accordance with the applicable provisions of Section 701.21 (a) through (g) above, to the extent that they are not inconsistent with this Section, and the following additional requirements:

(i) *Written Loan Policies.* The board of directors must adopt specific business loan policies and review them at least annually. The policies shall, at a minimum, address the following:

(A) Types of business loans that will be made;

(B) The credit union's trade area for business loans;

(C) Maximum amount of credit union assets, in relation to reserves, that will be invested in business loans;

(D) Maximum amount of credit union assets, in relation to reserves, that will be invested in a given category or type of business loan;

(E) Maximum amount of credit union assets, in relation to reserves, that will be loaned to any one member or group of associated members, subject to Section 701.21(h)(2)(iii)(A) below;

(F) Qualifications and experience of personnel involved in making and administering business loans with a minimum of 2 years direct experience with this type of lending;

(G) Analysis of the ability of the borrower to repay the loan;

(H) Documentation supporting each request for an extension of credit or an increase in an existing loan or line of credit shall (except where the board of directors finds that such documentation requirements are not generally available for a particular type of business loan and states the reasons for those findings in the credit union's written policies) include the following: balance sheet, cash flow analysis, income statement, tax data, leveraging, comparison with industry average, receipt and periodic updating of financial

NCUA LETTER TO CREDIT UNIONS

NCUA LETTER NO. 124

DATE: JUNE, 1991

TO THE BOARD OF DIRECTORS OF THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

Real estate secured loans at federally insured credit unions have increased over 137 percent in the last 5 years. This growth is the result of increased demand for real estate secured credit by members, as well as a drop in demand for other "consumer" loans for such items as automobiles.

Although growth during 1990 slowed to a 9-percent rate by yearend, over 34 percent of all loans outstanding to federally insured credit unions were secured by residential real estate. For many credit unions, real estate secured credit is the single largest balance sheet item.

Credit union boards of directors must clearly understand the risks and issues which must be addressed before becoming involved or expanding their involvement in real estate lending. These matters go far beyond the usual credit risk evaluation process required for "consumer" loans. In general, residential real estate loans are granted for larger amounts and for longer terms than "consumer" loans, and cash flow is lower than for shorter term loans. These distinguishing characteristics can create interest rate and liquidity risks. In addition, there is collateral risk that residential property values may drop due to local, regional or national market changes. Finally, diversification risk exists to the extent that the volume of real estate loans held in portfolio becomes a major portion of the credit union's income-producing assets.

Real estate lending is a necessary loan category for many credit unions. These guidelines are not intended to curtail such lending, but rather to clarify areas of risk and concern. NCUA Letter No. 112 and other real estate lending guidelines recently issued by some of the NCUA regional offices are superseded by these guidelines. These guidelines do not apply to "other real estate owned" (OREOs).

Credit unions which deviate significantly from these guidelines are expected to support and justify their policies and practices. The level of expertise expected in developing written real estate lending policies, asset/liability management strategies, use of secondary market conduits and other principles described in this letter shall be directly related to the level of involvement and exposure in real estate loans. Failure to recognize or to properly address the risks involved with residential real estate lending shall be considered an unsafe and unsound lending practice by NCUA examiners. Although this letter is intended to provide guidance and is not a regulatory requirement, we do expect to propose regulatory provisions in the areas of documentation, written lending policies, asset/liability management and staffing within the near future. The need to include additional regulatory provisions will be considered based on a review of examination findings.

The following guidelines apply to credit unions which grant residential real estate loans:

- Written Lending Policies. A written policy must be developed and approved by the board of directors. Policies should be reviewed periodically (at least annually). Since each credit union is unique, there is no single policy that can best serve all credit unions. Each credit union must tailor its policies and procedures to accomplish its goals and to meet the needs of its own members. Nevertheless, all policies should include, at a minimum, the following:

  - o Types of loans that will be offered, *i.e.,* first mortgage, second mortgage, home equity line of credit, fixed equity, conventional, VA or FHA;
  - o Loan limits concerning the percentage or amount of assets that will be committed to residential real estate loans. A limit by each loan type is recommended;
  - o Loan limits concerning the maximum amounts to be made available in aggregate to any single borrower (excluding loans sold into the secondary market);
  - o Debt ratios used to qualify loan applicants. Due consideration should be given that debt ratios in real estate lending differ from consumer lending and include factors such as the downpayment, LTV ratio, disposable income and market or collateral risk issues;

- Trade area in which residential real estate loans will be offered, consistent with the provisions of the Fair Housing Act;
- Qualification and experience requirements of personnel involved in making and administering loans;
- Maximum loan-to-value ratios for the various types of loans made available, including requirements for PMI at certain LTV levels. Provisions for adjusting LTV ratios based on changing market conditions may be appropriate;
- Pricing policy;
- Quality control policies to ensure adequate underwriting, servicing, follow-up and collection procedures; and
- Monitoring policies to assess the interest rate, credit and collateral risks.

- Secondary Market. Although credit unions are not required to sell loans to the secondary market, underwriting standard loans which conform to secondary market investor requirements provide a number of advantages to lenders:

- Standard loans meet proven industry standards which minimize credit risk;
- Standard loans are saleable, providing some protection from interest rate and liquidity risks;
- Standard loans produce improved yield on sale versus nonstandard products; and
- Standard loans are widely accepted by consumers (members) as the industry norm - simplifying marketing efforts.

Nonstandard loans should be limited to those which the credit union is safely able to hold to maturity, including asset/liability management concerns. The determination of "able to hold" should consider the level of capital in a credit union. Interest rate and liquidity risk are virtually eliminated for loans which are immediately sold into the secondary market. For loans that are not sold, these risks can be managed effectively by granting loans which are saleable into the secondary market and by careful adherence to an asset/liability management program which measures risk and indicates the point at which loans should be sold to minimize losses.

Writing loans to secondary market investor requirements does not require that a credit union qualify as a seller/servicer or master seller with one of the two dominant participants in the secondary market, the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC). Loans may also be sold to other mortgage conduits, including some who are credit union service organizations (CUSOs).

- Asset/liability Management. Credit unions engaged in residential real estate lending should adopt an asset/liability management policy that addresses, at a minimum, the rate sensitivity of the balance sheet, asset/liability maturity matching, liquidity and cash flow needs and interest rate risk. Examiner's have noted several instances where mortgage programs funded by high cost certificates of deposit have resulted in serious liquidity and interest rate mismatches. It is advisable to develop simulation models to test the effect of reasonable interest rate fluctuations on profitability and capital adequacy. Contingency plans should be considered to determine when and if loans should be sold in order to maintain cash flow, liquidity and profitability.

- Fixed Rate Loans. Because of the high level of interest rate risk, fixed rate long-term mortgages should only be carried by credit unions that have made them in conjunction with an ALM plan that is well thought out, carefully executed and regularly reviewed. Future saleability is an important factor with fixed rate loans.

- Adjustable (Variable) Rate Loans. The short repricing periods of adjustable rate loans (and balloon mortgages) help to reduce interest rate risk. However, infrequent adjustment periods with annual and lifetime interest rate caps mean that interest rate risk is not entirely eliminated. Balloon mortgages carry an additional risk of default during periods of rising interest rates because a borrower's ability to repay at the higher rate is limited. Interim monitoring of these loans is necessary. In addition, these loans are limited by the fact that their low interest rates mean lower earnings. Further, the low first-year rates that are offered to attract borrowers can mean negative earnings for a year, or longer, under some circumstances.

- Staffing. Credit union personnel who underwrite and administer residential real estate loans should be adequately trained and experienced prior to becoming involved with this type of lending. The use of untrained or inexperienced personnel shall be considered an unsafe and unsound lending practice. Credit unions may want to consider the use of qualified outside underwriters to review loans before closing to ensure that secondary market standards are met.

Following are some of the issues that must be considered to ensure that loans meet secondary market standards:

- Documentation - Uniform Instruments. Uniform instruments, as accepted by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), FNMA and FHLMC, are highly recommended. Use of other documents may be appropriate when the underlying loan is subject to sale to the secondary market and the contracting investor has stipulated the documentation which will be required. In general, most secondary market investors insist on the use of Uniform Instruments.

- Appraisals. Part 722 of the NCUA Rules and Regulations pertains to appraisal requirements. After January 1, 1992, an appraisal by a licensed or certified appraiser, as appropriate, is required for each residential real estate loan over $50,000. Transactions of $50,000 or less require a written estimate of value performed by an independent, qualified individual. Credit unions must ensure that the appraiser is competent to perform the work assigned. This requires investigation concerning the training and experience of the appraiser. Note, however, that for loans to be saleable on the secondary market, the appraisal must be completed by a licensed or certified appraiser, regardless of amount.

- Loan-to-Value (LTV) Ratio Limits. LTV limits should be established. For conventional loans, the maximum LTV permissible should be no greater than 80 percent of the lower of the appraised value or sales price unless private mortgage insurance (PMI) is obtained. The PMI should be obtained from a company acceptable to the credit union and to established secondary markets. On government insured loans, the LTV may not exceed the applicable FHA or VA guidelines.

- Credit Reports. Credit unions should normally obtain a credit report before granting a residential real estate loan. Credit reports should be acceptable to the established secondary market. Typically, secondary market investors require the use of a "residential mortgage credit report" as opposed to an "in file" credit report.

- Hazard Insurance. A hazard insurance policy, naming the credit union as loss payee, should be required on all residential real estate loans. The policy should be in the amount of the original loan balance or the replacement value of the structure, whichever is less. Coverage should be sufficient to pay the mortgage balance including prior liens, if any.

- Grace Periods and Interest Calculations Basis. Residential real estate loans documented for possible sale in secondary markets should have interest calculation bases acceptable to those markets. Generally, to satisfy this objective, loans must be based on a 30-day month/360-day year interest calculation basis and have a 15-day grace period. Use of a 30-day month, 15-day grace period and a late payment fee is consistent with member expectations, easier to administer and also facilitates future sale of the loan, if that should become necessary.

- Title Search and Abstract. A title search or abstract must be performed prior to the closing of all residential real estate loans to ensure that there is enough unencumbered equity in the property to secure the loan.

- Title Insurance. Credit unions which desire to originate first mortgage loans for possible sale into established secondary markets must obtain a lender's title insurance policy. Even if loans are not intended for sale, credit unions should consider the benefits of requiring lender's title insurance to protect the credit union's interests. Title insurance is also encouraged on second mortgage loans.

- o Indexes for Adjustable Rate Loans. The index used to establish the rate for adjustable rate loan programs should be acceptable to secondary markets and appropriate to the type of loan granted. Use of internal indexes for adjustable rate loans are normally not acceptable to secondary market investors or consumers. Finally, margins over the index should be acceptable to the secondary market.

In addition to policies and practices generally required by the secondary market, credit union real estate lending programs should also address the following:

- Construction Loans. Loans should be limited to those which finance the acquisition and construction of a member's principal residence. Construction involves the risks associated with the uncertainties of building. These loans carry a higher risk of default and, therefore, entail more extensive underwriting and administration than financing completed homes. Construction loans are expected to meet, at a minimum, the following requirements:

- o Detailed cost estimates and building plans should be obtained from the member before approval of the loan;
- o An evaluation of the quality of the builder including financial stability, experience, and track record should be performed. Builder's risk insurance should be considered;
- o Building permits should be acquired prior to disbursal of loan proceeds;
- o The member should provide substantial equity in the project (30 percent is suggested) consisting of funds or land value. The members' funds should be used before disbursing the proceeds of the loan. Loans involving unimproved land are considered highly speculative and lower LTV ratios should be required (50% to 60%);
- o An appraisal, meeting the requirements of Part 722 of the NCUA Rules and Regulations, must be obtained before approval, based on an "as is" condition, and as if completed to specified plans; and

- Funds must be released in stages based on the percentage of the home's completion, verified by on-site inspections. On-site inspections should be made only by qualified individuals, such as the original appraiser, independent of the underwriting function of the credit union. Before disbursing "draws", credit unions should consider updating the title search to ensure that the title remains clear.

- Compliance with Consumer Protection Laws. Residential real estate loans are subject to a number of special provisions concerning consumer protection. These include requirements of the Home Mortgage Disclosure Act, the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Flood Disaster Protection Act and the Real Estate Settlement Procedures Act, including the recent disclosure provisions regarding a change in loan servicers. Other requirements may also apply including state provisions and Internal Revenue Service reporting requirements. Credit unions involved with residential real estate lending must ensure that the provisions of these laws are met before granting such loans.

Home equity line of credit loans (HELOCs) require the same careful underwriting and administrative attention that is required of closed end loans (first and second mortgages, fixed equity loans). The following guidelines specifically apply to HELOCs:

- Written Lending Policies - The guidelines applicable to closed end loans apply equally to HELOCs.
- Secondary Market - HELOCs are generally not saleable at this time; therefore, standard underwriting standards are not available.
- Asset/liability Management - The guidelines applicable to closed end loans apply equally to HELOCs.
- Staffing - The guidelines applicable to closed end loans apply equally to HELOCs.
- Documentation - Uniform Instruments are not available. Credit unions should ensure that documents meet all state and federal laws.
- Appraisals - Part 722 of the NCUA Rules and Regulations applies equally to HELOCs.

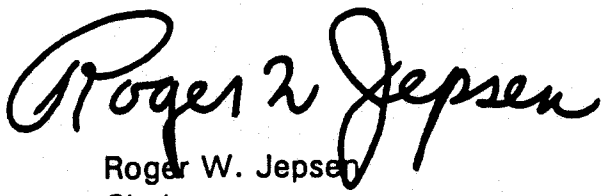
- Loan-to-Value (LTV) Ratios - LTV limits should be established.
- Credit Reports - A credit report should be obtained prior to granting the loan.
- Hazard Insurance - A hazard insurance policy, naming the credit union as loss payee, should be required. The policy should be in an amount sufficient to pay the maximum credit line granted, including any prior liens.
- Title Search and Abstract - A title search or abstract must be performed prior to closing the loan.
- Title Insurance - Credit unions are encouraged to consider the benefits of title insurance in connection with HELOCs.
- Indexes for HELOCs - The use of an internal index is not permissible under the Federal Truth in Lending Act. Indexes selected should be outside of the control of the credit union, and readily available to the public.

The secondary market for home equity loans is extremely limited; therefore, these products require careful underwriting and administration in order to avoid creating undue levels of risk. HELOCs generally feature long draw periods (up to 10 years) and extended repayment periods (5 years after the end of the draw period). Credit unions should tailor HELOCs to meet the needs of the members and the ability of the credit union to manage such programs.

Payments should be required at least quarterly, if not monthly. Repayment terms should call for regular principal and interest payments over the term of the loan and should provide for full amortization within a reasonable period after the close of the "draw" period. Credit risk can be managed by monitoring draws and repayments to ensure that, at the end of the draw period, borrowers have the capacity for repayment and sufficient collateral in case they can't pay. Agreements should allow for the periodic review of creditworthiness and collateral suitability.

In summary, real estate lending is a valuable service to credit union members and an important part of many credit union lending programs. Careful management of the risks associated with real estate lending is an important factor in creating a successful and profitable lending program. NCUA is committed to helping credit unions better understand and manage these risks. These guidelines provide a foundation for safe and sound real estate lending.

For the National Credit Union
Administration Board,



Roger W. Jepsen
Chairman

U.S. GOVERNMENT PRINTING OFFICE 1991 O—865-686

NCUA

LETTER TO CREDIT UNIONS

NCUA LETTER NO. 125

DATE: JUNE, 1991

TO THE BOARD OF DIRECTORS OF THE CREDIT UNION ADDRESSED:

The recently enacted 1990 National Affordable Housing Act (Act) contains several new requirements for lenders, including credit unions, originating and/or servicing mortgage loans. The Act amends other existing regulations. Specifically, the addition of Section 6 to the Real Estate Settlement Procedures Act (RESPA) requires disclosure to mortgage applicants of historical data regarding the transfer of mortgage servicing. Enclosure (1) is a summary of the various requirements of the Act.

Additionally, on March 20, 1991, the Department of Housing and Urban Development (HUD) issued a "Federal Register Notice" on the Act. This notice, Enclosure (2), contains the following sample statements:

- "Disclosure Statement"; and
- "Notice of Assignment, Sale or Transfer of Servicing Rights"

Credit unions are required to make the disclosures upon application for a mortgage and upon transfer of servicing rights. The models in Enclosure (2) may be used for this purpose.

If you have any questions about the National Affordable Housing Act requirements and the regulations it affects, please call the National Credit Union Administration regional office serving your credit union.

For the National Credit Union Administration Board,

Roger W. Jepsen
Chairman

Enclosures

NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF EXAMINATION AND INSURANCE
COMPLIANCE UPDATE

1990 National Affordable Housing Act

General Overview

On November 28, 1990, President Bush signed the Cranston-Gonzalez National Affordable Housing Act (Act), which has several provisions affecting mortgage lenders and servicers. The Act's numerous provisions include disclosure requirements for the transfer of mortgage servicing, for escrow accounts, and for prepayment of FHA loans. The Act also extends the deadline and modifies the requirements for the homeownership counselling program.

I. Mortgage Servicing Provisions

Section 941 of the Act amends the Real Estate Settlement Act (RESPA) and requires detailed disclosure of the transfer, sale, or assignment (transfer) of mortgage servicing. The disclosure requirements apply only to federally related mortgage loans (defined by RESPA as any loan made by a lender regulated by any agency of the federal government, or whose deposits or accounts are insured by an agency of the federal government) subject to RESPA.

Disclosures at Application

Disclosures provided at the time of application must state whether servicing is expected to be transferred while the loan is outstanding. The originating lender must disclose, among other things, the percentage of all loans, within the nearest 25 percent, transferred during the most recent three calendar years, and an estimate of the percentage of loans which will be transferred in the 1-year period after origination. The disclosure must include a signed statement that the applicant has read and understood the disclosure.

Current Servicer's Disclosure at Time of Transfer

The current servicer must provide notice not less than 15 days before the effective date of transfer of servicing. Alternatively, it can be provided at settlement. The notice must include the effective date of the transfer; the current and new servicer's names, addresses, and toll free or collect call phone numbers; the dates on which the servicer will cease accepting payments and the new servicer will begin accepting payments; information on the continued availability of optional insurance policies; and a statement that the transfer does not affect any term of the mortgage other than terms directly related to servicing the mortgage.

New Servicer's Disclosure at Time of Transfer

The same notice (provided by the current servicer) must be provided by the new servicer not more than 15 days after the effective date of transfer (unless the current servicer was the originating lender and provided the notice at settlement).

Other Provisions Under Section 941

1. The servicer must make payments from the borrower's required escrow account (for taxes, insurance premiums, etc.) in a timely manner as payments become due.

2. Servicers are prohibited from assessing a late fee for 60 days after transfer when the payment is timely but has been sent to the wrong servicer.

3. The servicer must provide a written acknowledgment of a borrower's written inquiry about the servicing of a loan within 20 days and either correct the error or explain why the account is correct within 60 days.

4. The servicer may not provide information concerning a borrower's disputed payments to a consumer reporting agency (credit bureau) during the 60-day period following receipt of the written request by the borrower concerning a payment dispute.

Liability

Failure to comply with any of the mortgage servicing provisions may subject the servicer to significant liability. The liability provisions are similar to those for a violation of the Truth in Lending Act. The borrower may receive up to $1,000 in punitive damages by showing a pattern or practice of noncompliance. In a class action, punitive damages may not exceed the lesser of: $1,000 for each member of the class; one percent of the net worth of the servicer; or $500,000. Liability may be avoided if, within 60 days after discovering an error, the servicer notifies the borrower of the error and makes appropriate adjustments to the account.

Effective Date

Section 941 of the Act does not state when servicers must begin to comply with its provisions. The Department of Housing and Urban Development (HUD) published in the Federal Register a model disclosure statement and an acknowledgment form for disclosures at application on March 20, 1991. Conceivably, compliance was required as of November 29, 1990, for the latter provisions, if not for all of the disclosures required by this section. Servicers should be aware that compliance could be required immediately.

II. Mortgage Escrow Account Provisions

Section 942 of the Act pertains only to escrow accounts and has its own liability provisions. It requires several disclosures about escrow accounts including a notice of any shortage of funds in the account.

Disclosures at Closing

The servicer must provide a statement at closing or within 45 days of establishing an escrow account itemizing charges to be paid during the first 12-month period after settlement and stating the anticipated dates of such payments. If the statement is provided at closing, it may be incorporated into the uniform settlement statement (HUD-1).

Annual Disclosures

The servicer must provide an annual statement itemizing amounts placed in escrow by the borrower and paid out of the account by the servicer. Servicers may not impose a fee for preparation and mailing of this statement. The first annual statement must cover the 12-month period beginning January 1, 1991, and should be mailed no later than January 30, 1992, and annually thereafter.

Liability

HUD may impose a fine of $50 for each failure to provide an annual statement not to exceed $100,000 in a 12-month period. If the failure to comply is deemed intentional, each violation is subject to a $100 penalty with no limit on the total liability.

III. Disclosure of Prepayment of FHA Loans

Section 329 of the Act requires disclosures concerning prepayment of FHA loans. When an FHA loan is prepaid, interest is collected from the date of payment through the scheduled payment date. The section requires servicers of FHA-insured loans to provide borrowers at or before closing with a written notice (to be prescribed by HUD) describing requirements the borrower must fulfill to avoid the accrual of interest after prepayment of an FHA loan. It also requires an annual written notice stating the amount of principal outstanding. The annual statement must also describe requirements the borrower must fulfill to avoid the accrual of interest after prepayment of an FHA loan.

Effective Date

HUD has 90 days from November 28, 1990, to issue regulations for these provisions. The provisions concerning disclosures at closing will apply to loans executed after the expiration of the 90-day period. The annual statement requirement, however, applies to FHA loans outstanding as of the expiration of the 90-day period.

IV. Homeownership Counseling

Section 576 of the Act requires lenders to inform borrowers within 45 days of an initial loan default of the availability of homeownership counseling. Lenders were previously required to notify delinquent borrowers of the availability of counseling but no specific time frame was required. The section extends the housing counseling requirements through September 30, 1992.

Effective Date

The counseling notification provisions are effective immediately.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Assistant Secretary for Housing—Federal Housing Commissioner

[Docket No. N-91-3191; FR-2942-N-01]

Real Estate Settlement Procedures Act, Section 6 Model Disclosure Statement and Applicant's Acknowledgement of Servicing Transfer; Sample Language for Transfer Notification

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner.

ACTION: Notice

SUMMARY: This Notice sets forth the Model Disclosure Statement and Applicant's Acknowledgment (hereafter generally called Disclosure Statement) required by the Cranston-Gonzalez National Affordable Housing Act (Pub. L. 101-625, approved November 28, 1990) (the Act) regarding the potential transfer of mortgage servicing for any federally-related mortgage loan. "Federally-related mortgage loan" is defined in section 3(1) of the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. 2601 *et seq.*) and the definition is refined in the implementing regulation for RESPA (Regulation X) (24 CFR 3500) at § 3500.5(b). Certain exceptions from coverage are set forth in § 3500.5(d). This Disclosure Statement must be given to every applicant for a federally-related mortgage loan, which includes nearly every one- to four family residential mortgage loan in the United States.

EFFECTIVE DATE: March 20, 1991.

FOR FURTHER INFORMATION CONTACT: Grant E. Mitchell or John B. Shumway, Office of General Counsel, (202) 708-1550, room 10248, Department of Housing and Urban Development, 451 7th Street, SW., Washington, DC 20410. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION:

Paperwork Requirements

The information collection requirements contained in this Notice have been approved for a period of 60 days by the Office of Management and Budget, under section 3504(h) of the Paperwork Reduction Act of 1980 (44 U.S.C. 3054(h)), and assigned OMB control number 2502-0458. The public reporting burden for each of these collections of information is estimated to include the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Information on the estimated public reporting burden is provided under the Preamble heading, Other Matters. Send comments regarding this burden estimate or any other aspect of this collection information, including suggestions for reducing this burden, within 30 days from the date of this Notice to the Department of Housing and Urban Development, Rules Docket Clerk, 451 Seventh Street SW., room 10276, Washington, DC 20410; and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503.

Description	Disclosure to Applicant	Notice of assignments	Total
Number of respondents	20,000 [1]	20,000 [1]	20,000
Average # per respondent	200	3,000	
Total annual responses	4,000,000	60,000,000	64,000,000
Hours per response	2 minutes (0.033 hr)	6 minutes (0.10 hr)	
Total hours	132,000	6,000,000	6,132,000
Annual cost	$2 million [2]	$90 million [3]	$92,000,000

[1] These are the same 20,000 respondents.
[2] Includes labor at the rate of $10 per hour, plus miscellaneous costs.
[3] Includes $9.50 per Notice for postage and miscellaneous costs.

Section 941 of the Cranston-Gonzalez National Affordable Housing Act (Pub. L. 101-625, approved November 28, 1990) (the Act) amended the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. 2601 *et seq.*) by adding a new section 6, which requires disclosure to applicants of historical data regarding the transfer of mortgage servicing (that is, the right to collect mortgage payments for principal, interest and escrow account items). The amendment also requires that potential borrowers be given information concerning the likelihood that their mortgage servicing might be transferred. Section 6 sets forth additional notice requirements and other rights for borrowers and provides for the collection of damages and costs by borrowers from servicers for noncompliance.

HUD is complying with the requirements of sections 6(a)(2) and 6(a)(3) to promulgate a Model Disclosure Statement and Applicant's Acknowledgement. HUD has also provided sample language that HUD believes will assist mortgage servicers in complying with the other notice requirements set out in the new section 6. The sample language may be used by the present servicer and new servicer separately, or in a single notice, so long as the timing provisions of section 6 are met. While HUD anticipates that the use of this sample language will help assure buyers and sellers of mortgage servicing that the notice requirements of section 6 have been followed, the use of this language is not mandatory.

All of the provisions of Section 6 appear on their face to be effective immediately upon enactment of the Act. Sections 6(a)(2) and 6(a)(3), however, give the Secretary 90 days from the date of enactment to develop a Model Disclosure Statement and Applicant's Acknowledgement. HUD concludes, therefore, that development of this Model Disclosure Statement and Applicant's Acknowledgement is a *sine qua non* for lender compliance. Section 6(a) is therefore effective upon publication of this Notice.

Certain clarifications by the Congressional Conferees regarding mortgage servicing (136 Cong. Rec. S17138, October 26, 1990) and in the Joint Explanatory Statement of the Committee of Conference for the Act indicate a Congressional intent that sections 6(b), 6(c), 6(d) and 6(e) of the Act were to become effective 60 days from the date of enactment, and not immediately upon enactment. HUD is persuaded that Congress intended a 60-day delay to allow servicers to phase in the procedures set out in sections 6(b), 6(c), 6(d) and 6(e). However, this reference to a 60-day delay in the legislative history does not fully protect servicers from lawsuits for actions during the first 60 days after enactment of the Act, and HUD has no authority under section 941 to administratively implement this 60-day delay. However, HUD believes that a technical amendment to the Act may be enacted by Congress to eliminate lender exposure during the first 60 days after enactment, and possibly until

rulemaking on section 941 is completed. Further rulemaking dealing with provisions of the new section 6, including the preemption of state law provisions, has been initiated and will follow this Notice.

Set forth below is the Disclosure Statement and sample language pursuant to section 6 of RESPA. The Disclosure Statement is to be delivered to the applicant at the time of application, and the Applicant's Acknowledgement portion is to be signed by the applicant, and co-applicant, if any. If no face to face interview is held at the time of application, the Disclosure Statement is to be delivered to the applicant upon receipt of the application. An executed Disclosure Statement is a required part of any application package. If an application is received by a mortgage broker, that broker is responsible for assuring that the Disclosure Statement is provided to the applicant by any lender with whom the loan is placed. If co-applicants indicate the same address on their application, one copy delivered to the address shown is sufficient. If different addresses are shown on the application or if the Disclosure Statement is to be executed in counterparts, a copy must be delivered to each of the applicants. Delivery is effectuated by placing the document in the mail, with prepaid first-class postage. There is currently no limit on the record retention period for copies of the executed Disclosure Statements, although HUD anticipates that Congress may later enact a statute of limitations provision for actions under this Section.

BILLING CODE 4210-27-M

DISCLOSURE STATEMENT
[Use Lender's business stationery or similar heading]

NOTICE TO MORTGAGE LOAN APPLICANTS: THE RIGHT TO COLLECT YOUR MORTGAGE LOAN PAYMENTS MAY BE TRANSFERRED. FEDERAL LAW GIVES YOU CERTAIN RIGHTS. READ THIS STATEMENT AND SIGN IT ONLY IF YOU UNDERSTAND ITS CONTENTS.

Because you are applying for a mortgage loan covered by the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. §2601 et seq.) you have certain rights under that Federal law. This statement tells you about those rights. It also tells you what the chances are that the servicing for this loan may be transferred to a different loan servicer. "Servicing" refers to collecting your principal, interest and escrow account payments. If your loan servicer changes, there are certain procedures that must be followed. This statement generally explains those procedures.

Transfer practices and requirements

If the servicing of your loan is assigned, sold, or transferred to a new servicer, you must be given written notice of that transfer. The present loan servicer must send you notice in writing of the assignment, sale or transfer of the servicing not less than 15 days before the date of the transfer. The new loan servicer must also send you notice within 15 days after the date of the transfer. Also, a notice of prospective transfer may be provided to you at settlement (when title to your new property is transferred to you) to satisfy these requirements. The law allows a delay in the time (not more than 30 days after a transfer) for servicers to notify you under certain limited circumstances, when your servicer is changed abruptly. This exception applies only if your servicer is fired for cause, is in bankruptcy proceedings, or is involved in a conservatorship or receivership initiated by a Federal agency.

Notices must contain certain information. They must contain the effective date of the transfer of the servicing of your loan to the new servicer, the name, address, and toll-free or collect call telephone number of the new servicer, and toll-free or collect call telephone numbers of a person or department for both your present servicer and your new servicer to answer your questions about the transfer of servicing. During the 60-day period following the effective date of the transfer of the loan servicing, a loan payment received by your old servicer before

its due date may not be treated by the new loan servicer as late, and a late fee may not be imposed on you.

Complaint Resolution

Section 6 of RESPA (12 U.S.C. §2605) gives you certain consumer rights, whether or not your loan servicing is transferred. If you send a "qualified written request" to your loan servicer concerning the servicing of your loan, your servicer must provide you with a written acknowledgment within 20 business days of receipt of your request. A "qualified written request" is a written correspondence, other than notice on a payment coupon or other payment medium supplied by the servicer, which includes your name and account number, and your reasons for the request. Not later than 60 business days after receiving your request, your servicer must make any appropriate corrections to your account, and must provide you with a written clarification regarding any dispute. During this 60-day period, your servicer may not provide information to a consumer reporting agency concerning any overdue payment related to such period or qualified written request.

Damages and Costs

Section 6 of RESPA also provides for damages and costs for individuals or classes of individuals in circumstances where servicers are shown to have violated the requirements of that Section.

Servicing Transfer Estimates by Original Lender

The following is the best estimate of what will happen to the servicing of your mortgage loan:

1. _____ We do not service mortgage loans. We intend to assign, sell, or transfer the servicing of your loan to another party. You will be notified at settlement regarding the servicer.

OR

2. _____ We are able to service this loan and presently intend to do so. However, that may change in the future. For all the loans that we make in the 12-month period after your loan is funded, we estimate that the chances that we will transfer the servicing of those loans is between:

_____ 0 to 25%

_____ 26 to 50%

_____ 51 to 75%

_____ 76 to 100%

This is only our best estimate and it is not binding. Business conditions or other circumstances may affect our future transferring decisions.

3. This is our record of transferring the servicing of the loans we have made in the past:

Year	Percentage of Loans Transferred	(Rounded to nearest quartile-0%, 25%, 50%, 75% or 100%)
19__	_____ %	
19__	_____ %	
19__	_____ %	

The estimates in 2. and 3. above do not include transfers to affiliates or subsidiaries. If the servicing of your loan is transferred to an affiliate or subsidiary in the future, you will be notified in accordance with RESPA.

_____

LENDER [Signature Not Mandatory]

_____

DATE

INSTRUCTIONS TO PREPARER: For applications received in calendar year 1991 after the effective date of this Notice, the information in 2. above will be for calendar year 1990 only; for applications received in 1992, this information will be for calendar years 1990 and 1991; and for applications received in 1993 and thereafter, this information will be for the previous three calendar years.

ACKNOWLEDGEMENT OF MORTGAGE LOAN APPLICANT

I/we have read this disclosure form, and understand its contents, as evidenced by my/our signature(s) below.

_____

APPLICANT'S SIGNATURE

_____

CO-APPLICANT'S SIGNATURE

_____

DATE

[SAMPLE LANGUAGE]

NOTICE OF ASSIGNMENT, SALE OR TRANSFER
OF SERVICING RIGHTS

You are hereby notified* that the servicing of your mortgage loan, that is, the right to collect payments from you, is being assigned, sold or transferred from _____ to _____, effective _____.

The assignment, sale or transfer of the servicing of the mortgage loan does not affect any term or condition of the mortgage instruments, other than terms directly related to the servicing of your loan.

Except in limited circumstances, the law requires that your present servicer send you this notice at least 15 days before this effective date or at closing. Your new servicer must also send you this notice no later that 15 days after this effective date or at closing. [In this case, the present servicer and the new servicer have combined all necessary information in this one notice].

Your present servicer is _____. If you have any questions relating to the transfer of servicing from your present servicer call _____ [enter the name of an individual or department here] between _____ a.m. and _____ p.m. on the following days _____ _____. This is a toll-free [or collect call] number.

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* This notification is a requirement of Section 6 of the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. §2605).

INSTRUCTIONS TO PREPARER: Delivery means placing the notice in the mail, first class postage prepaid, prior to 15 days before the effective date of transfer (transferor) or prior to 15 days after the effective date of transfer (transferee). However, this notice may be sent not more than 30 days after the effective date of the transfer of servicing rights if assignment, sale or transfer of the servicing of the mortgage loan is preceded by termination of the contract for servicing the loan for cause, commencement of proceedings for bankruptcy of the servicer, or commencement of proceedings by the Federal Deposit Insurance Corporation (FDIC) or the Resolution Trust Corporation (RTC) for conservatorship or receivership of the servicer, or an entity by which the servicer is owned or controlled.

Your new servicer will be _____. The business address for your new servicer is: _____. The toll-free [or collect call] telephone number of your new servicer is _____. If you have any questions relating to the transfer of servicing to your new servicer call _____ [enter the name of an individual or department here] at _____ [toll free or collect call telephone number] between _____ a.m. and _____ p.m. on the following days _____.

The date that your present servicer will stop accepting payments from you is _____. The date that your new servicer will start accepting payments from you is _____.

[Use this paragraph if appropriate; otherwise omit] The transfer of servicing rights may affect the terms of or the continued availability of mortgage life or disability insurance or any other type of optional insurance in the following manner _____ _____ _____ _____ _____ and you should take the following action to maintain coverage: _____ _____ _____ _____.

You should also be aware of the following information, which is set out in more detail in Section 6 of RESPA (12 U.S.C. $2605):

During the 60-day period following the effective date of the transfer of the loan servicing, a loan payment received by your old servicer before its due date may not be treated by the new loan servicer as late, and a late fee may not be imposed on you.

Section 6 of RESPA (12 U.S.C. $2605) gives you certain consumer rights. If you send a "qualified written request" to your loan servicer concerning the servicing of your loan, your servicer must provide you with a written acknowledgment within 20 business days of receipt of your request. A "qualified written request" is a written correspondence, other than notice on a payment coupon or other payment medium supplied by the servicer, which includes your name and account number, and your reasons for the request. Not later than 60 business days after receiving your request, your servicer must make any appropriate corrections

to your account, and must provide you with a written clarification regarding any dispute. During this 60-day period, your servicer may not provide information to a consumer reporting agency concerning any overdue payment related to such period or qualified written request.

Section 6 of RESPA also provides for damages and costs for individuals or classes of individuals in circumstances where servicers are shown to have violated the requirements of that Section. You should seek legal advice if you believe your rights have been violated.

Authority: Real Estate Settlement Procedures Act of 1974, as amended (12 U.S.C. 2601 *et seq.*).

Dated: March 14, 1991.

Arthur J. Hill,

Acting Assistant Secretary for Housing—Federal Housing Commissioner.

§701.26 Credit Union Service Contracts.

(a) A Federal credit union may act as a representative of and enter into a contractual agreement with one or more credit unions or other organizations for the purpose of sharing, utilizing, renting, leasing, purchasing, selling, and/or joint ownership of fixed assets or engaging in activities and/or services which relate to the daily operations of credit unions. Agreements must be in writing, and shall advise all parties subject to the agreement that the goods and services provided shall be subject to examination by the NCUA Board to the extent permitted by law.

(b) Where any agreement calls for, or requires, the payment in advance of the actual or estimated charges for more than 3 months such payment shall be deemed an investment in a credit union service organization and subject to the limitations delineated in Sections 107(7)(I) and 107(5)(D) of the Federal Credit Union Act (12 U.S.C. Sections 1757(5)(I) and 1757 (5)(D)).

§701.27 Investments in and Loans to Credit Union Service Organizations.

(a) *Scope.* Sections 107(7)(I) and 107(5)(D) of the Federal Credit Union Act (12 U.S.C. 1757(7)(I) and 1757(5)(D)) authorize Federal credit unions to invest in and make loans to credit union service organizations. This regulation implements those sections by addressing various issues, including monetary limits on loans and investments, the structure of credit union service organizations, their customer base, and the range of services and activities that they may provide. The regulation also establishes prudential standards for Federal credit union involvement with credit union service organizations, through provisions concerning conflicts of interest, accounting practices, and NCUA access to books and records. The regulation applies only in cases where one or more Federal credit unions have invested in or made loans to an organization pursuant to Sections 107(7)(1) or 107(5)(d). The regulation does not regulate credit union service organizations directly but rather establishes conditions of Federal credit union investments in and loans to such organizations.

(b) *Limits imposed by the Federal Credit Union Act.*

(1) Section 107(7)(1) of the Act:

(i) Authorizes a Federal credit union to invest in shares, stocks or obligations of credit union service oganizations in amounts not exceeding, in the aggregate, 1% of the credit union's paid-in and unimpaired capital and surplus;

(ii) Limits credit union service organizations to providing services associated with the routine operations of credit unions; and

(iii) Prohibits a Federal credit union from utilizing this authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility, or other similar organization.

(2) Section 107(5)(D) of the Act:

(i) Authorizes a Federal credit union to make loans to credit union service organizations in amounts not exceeding, in the aggregate, 1% of its paid-in and unimpaired capital and surplus (this is independent of the 1% investment limit pursuant to Section 107(7)(I);

(ii) Requires that credit union service organizations exist primarily to meet the needs of their member credit unions; and

(iii) Limits credit union service organizations to business relating to the daily operations of the credit unions they serve.

(c) *Definitions.*—(1) *Affiliated credit unions* means those credit unions that have either invested in or made loans to a credit union service organization.

(2) *Official* means any director or committee member.

(3) *Immediate family member* means a spouse or other family members living in the same household.

(4) *Paid-in and unimpaired capital and surplus* means shares and undivided earnings.

(5) *Senior management employee* means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(d) *Regulatory provisions.*—(1) *Limits on funding.* A Federal credit union by itself, with other credit unions and/or with non-credit union parties, may invest in and/or loan to a credit union service organization. A Federal credit union's investments in credit union service organizations may not exceed, in the aggregate, 1% of the Federal credit union's paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. A Federal credit union's loans to credit union service organizations may not exceed, in the aggregate, 1% of the Federal credit union's paid-in and unimpaired capital and surplus as of its last calendar year-end financial report.

12 C.F.R. § 701.27

(2) *Structure.* A Federal credit union may invest in or loan to a credit union service organization only if the organization is structured as either a corporation or limited partnership.

(i) *Corporation.* A credit union service organization chartered as a corporation must be adequately capitalized and operated as a separate entity. A Federal credit union investing in or making loans to such a corporation must take those steps necessary to ensure that it will not be held liable for obligations of the corporation.

(ii) *Limited partnership.* A Federal credit union may participate only as a limited partner in a credit union service organization structured as a limited partnership. As a limited partner, the Federal credit union must not engage in those activities (e.g., control, management, decision-making), which, under state law, would cause the credit union to lose its status as limited partner, and correspondingly its limited liability, and be treated as a general partner.

(3) *Legal opinion.* A Federal credit union making an investment in or loan to a credit union service organization must obtain written legal advice as to whether the credit union service organization is established in a manner that will limit the credit union's potential exposure to no more than the loss of funds invested in or lent to the credit union service organization.

(4) *Customer base.* A Federal credit union may invest in or loan to a credit union service organization only if the organization primarily serves credit unions and/or the membership of affiliated credit unions (as defined in paragraph (c)(1) of this Section).

(5) *Permissible services and activities.* A Federal credit union may invest in and/or loan to those credit union service organizations that provide only one or more of the following services and activities:

(i) *Operational services.* Credit card and debit card services; check cashing and wire transfers; internal audits for credit unions; ATM services; EFT services; accounting services; data processing; shared credit union branch (service center) operations; sale of repossessed collateral; management, development, sale or lease of fixed assets; sale, lease or servicing of computer hardware or software; management and personnel training and support; payment item processing; locator services; marketing services; research services; record retention and storage; microfilm and microfiche services; alarm-monitoring and other security services; debt collection services; credit analysis; consumer mortgage loan origination; loan processing, servicing and sales; coin and currency services; provision of forms and supplies.

(ii) *Financial services.* Financial planning and counseling; retirement counseling; investment counseling; securities brokerage services; estate planning; income tax preparation; acting as administrator for prepaid legal service plans; developing and administering IRA, Keogh, deferred compensation, and other personnel benefit plans; trust services; acting as trustee, guardian, conservator, estate administrator, or in any other fiduciary capacity; real estate brokerage services; travel agency services; agency for sale of insurance; personal property leasing; and provision of vehicle warranty programs.

(iii) *NCUA approval of other services.* Any service or activity which is not authorized in paragraph (d)(5)(i) or (ii) of this Section must receive NCUA Board approval before a Federal credit union may invest in and/or loan to the credit union service organization that offers the service or activity. Any request from NCUA Board approval of a new service or activity should include a full explanation and complete documentation of the service or activity and how that service or activity is associated with routine credit union operations. The request should be submitted to the appropriate NCUA Regional Office. The request will be treated as a petition to amend paragraph (d)(5)(i) or (ii) of this Section and NCUA will request public comment or otherwise act on the petition within 60 days after receipt.

(6) *Conflict of interest.* (i) Individuals who serve as officials of, or senior management employees of, an affiliated Federal credit union (as defined in (c)(1)), and immediate family members of such individuals, may not receive any salary, commission, investment income, or other income or compensation from a credit union service organization either directly or indirectly, or from any person being served through the credit union service organization. This provision does not prohibit an official or senior management employee of a Federal credit union from assisting in the operation of a credit union service organization, provided the individual is not compensated by the credit union service organization. Further, the credit union service organization may reimburse the Federal credit union for the services provided by the individual.

(ii) The prohibition contained in paragraph (d)(6)(i) also applies to any employee not otherwise covered if the employee is directly involved in dealing with the credit union service organization unless the board of directors determines that the employee's position does not present a conflict of interest.

(iii) All transactions with business associates or family members not specifically prohibited by

this subsection (d)(6) must be conducted at arm's length and in the interest of the credit union.

(7) *Accounting procedures; access to information*—(i) *Federal credit union accounting.* A Federal credit union must follow generally accepted accounting principles (GAAP) in its involvement with credit union service organizations.

(ii) *Credit union service organization accounting; audits and financial statements; NCUA access to books and records.* An affiliated Federal credit union must obtain written agreements from a credit union service organization, prior to investing in or lending to the organization, that the organization will:

(A) Follow GAAP.

(B) Render financial statements (balance sheet and income statement) at least quarterly and obtain a Certified Public Accountant audit annually and provide copies of such to the affliated Federal credit union, and

(C) Provide the NCUA Board, or its representatives, with complete access to any books and records of the credit union service organization, as deemed necessary by the Board in carrying out its responsibilities under the Federal Credit Union Act.

(8) *Preexisting credit union service organizations.*

(i) Any Federal credit union investments in existence prior to the effective date of this regulation. May 27, 1986, must conform with this regulation not later than May 27, 1987, unless the NCUA Board grants its prior approval to continue such investment for a stated period.

(ii) Any Federal credit union loans in existence prior to the effective date of this regulation must conform with this regulation not later than May 27, 1987, unless:

(A) The NCUA Board grants its prior approval to continue the loan for a stated period, or

(B) Under the terms of its loan agreement the Federal credit union cannot require accelerated repayment without breaching the agreement.

(e) *Other laws.* A credit union service organization must comply with applicable Federal, state and local laws.

§701.28 Deleted July 1982.

§701.29 Deleted June 1979.

§701.30 Safe Deposit Box Service.

A Federal credit union may lease safe deposit boxes to its members.

§701.31 Nondiscrimination Requirements.

(a) *Definitions:* As used in this part, the term:

(1) "application" carries the meaning of that term as defined in 12 C.F.R. 202.2(f) (Regulation B), which is as follows: "An oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested";

(2) "dwelling" carries the meaning of that term as defined in 42 U.S.C. 3602(b) (Fair Housing Act), which is as follows: "Any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for the construction or location thereon of any building, structure, or portion thereof"; and

(3) "real estate-related loan" means any loan for which application is made to finance or refinance the purchase, construction, improvement, repair, or maintenance of a dwelling.

(b) *Nondiscrimination in Lending:*

(1) A Federal credit union may not deny a real estate-related loan, nor may it discriminate in setting or exercising its rights pursuant to the terms or conditions of such a loan, nor may it discourage an application for such a loan, on the basis of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With regard to a real estate-related loan, a Federal credit union may not consider a lending criterion or exercise a lending policy which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) Consideration of any of the following factors in connection with a real estate-related loan is not necessary to a Federal credit union's