

Press Releases

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OTS 05-50 - Federal Financial Regulatory Agencies Propose Guidance on Nontraditional Mortgage Products

Office of Thrift Supervision

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For further information

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Joint Release

**Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Office of Thrift Supervision**

Federal Financial Regulatory Agencies Propose Guidance on Nontraditional Mortgage Products

The federal financial regulatory agencies today issued for comment proposed guidance on residential mortgage products that allow borrowers to defer repayment of principal and sometimes interest.

These nontraditional mortgage products include "interest-only" mortgage loans where a borrower pays no principal for the first few years of the loan and "payment option" adjustable-rate mortgages where a borrower has flexible payment options, including the potential for negative amortization. Institutions are also increasingly combining these mortgages with other practices, such as making simultaneous second-lien mortgages and allowing reduced documentation in evaluating the applicant's creditworthiness.

While innovations in mortgage lending can benefit some consumers, the agencies are concerned that these practices can present unique risks that institutions must appropriately manage. They are also concerned that these products and practices are being offered to a wider spectrum of borrowers, including subprime borrowers and others who may not otherwise qualify for more traditional mortgage loans or who may not fully understand the associated risks of nontraditional mortgages.

The proposed guidance discusses the importance of carefully managing the potential heightened risk levels created by these loans. Toward that end, management should:

- Assess a borrower's ability to repay the loan, including any balances added through negative amortization, at the fully indexed rate that would apply after the introductory

period. The agencies recognize that this requirement differs from underwriting standards at some institutions and are specifically requesting comment on this aspect of the guidance.

- Recognize that certain nontraditional mortgage loans are untested in a stressed environment and warrant strong risk management standards as well as appropriate capital and loan loss reserves.
- Ensure that borrowers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice.

Comment is requested on all aspects of the guidance, particularly on the section regarding comprehensive debt service qualification standards. Comments are due sixty days after publication in the Federal Register. The guidance is attached.

Federal Register - <http://www.occ.gov/static/news-issuances/ots/press-releases/ots-pr-2005-50a.pdf>

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The Office of Thrift Supervision, an office of the Department of the Treasury, regulates and supervises the nation's thrift industry. OTS's mission is to ensure the safety and soundness of, and compliance with consumer protection laws by, thrift institutions, and to support their role as home mortgage lenders and providers of other community credit and financial services. OTS also oversees the activities and operations of thrift holding companies that own or control thrift institutions. Copies of OTS news releases and other documents are available at the OTS web page at www.ots.treas.gov.