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DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 545, 556, 560, 563, 571

[No. 96-111]

RIN 1550-AA89

Conflicts of Interest, Corporate Opportunity and Hazard Insurance

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Office of Thrift Supervision (OTS or agency) is today issuing a final rule updating and substantially streamlining its regulations and policy statements concerning conflicts of interest, usurpation of corporate opportunity and hazard insurance. These amendments are being made pursuant to the Regulatory Reinvention Initiative of the Vice President's National Performance Review (Reinvention Initiative) and section 303 of the Community Development and Regulatory Improvement Act of 1994 (CDRIA), which requires OTS and other federal banking agencies to review, streamline, and modify regulations and policies to improve efficiency, reduce unnecessary costs, and remove inconsistent, outmoded and duplicative requirements.

EFFECTIVE DATE: January 1, 1997.

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SUPPLEMENTARY INFORMATION:

TABLE OF CONTENTS

- I. Background
 - II. Summary of Comments and Description of the Final Rule
 - A. General Discussion of the Comments
 - B. Section-by-Section Analysis
 - C. Description of Final Rule
 - III. Disposition of Existing Conflicts of Interest, Corporate Opportunity and Hazard Insurance Regulations and Policy Statements
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- IV. Executive Order 12866
 - V. Unfunded Mandates Act of 1995
 - VI. Regulatory Flexibility Act Analysis
 - I. Background

In a comprehensive review of its regulations, beginning in the spring of 1995,

pursuant to section 303 of the CDRIA¹ and the Administration's Reinvention Initiative, OTS identified its conflicts of interest, corporate opportunity and hazard insurance regulations and policy statements as an important area for updating and streamlining. Each conflicts of interest, corporate opportunity and hazard insurance regulation and policy statement was reviewed to determine whether it was current and understandable; imposed the least possible burden consistent with safety and soundness and statutory requirements; addressed subject matter more suited for handbook guidance; and was written in a clear, straightforward manner. OTS also sought industry input regarding staff's initial recommendations through an industry focus group consisting of five thrift representatives, an industry trade association and OTS staff. As a result of this review, OTS identified a number of ways in which its conflicts of interest, corporate opportunity and hazard insurance regulations and policy statements could be revised to reduce regulatory burden. On June 14, 1996, OTS issued a notice of proposed rulemaking.²

Today's final rule is substantially similar to the June proposal. The conflicts of interest rule has been clarified to give more specificity on what conflicts are prohibited. The conflicts of interest provisions apply if there is disclosure to the board of directors, the interested person refrains from participation in discussion of the

¹ 12 U.S.C. 4803(a)(1).

² 61 FR 30190 (June 14, 1996).

transaction and recuses himself or herself from voting on the transaction. In addition, the final rule on corporate opportunity incorporates a safe harbor. The corporate opportunity safe harbor applies if there is disclosure to the board of directors, and a disinterested and independent majority of the board rejects the proposed business opportunity.

The final rule reduces the number of conflicts of interest, corporate opportunity and hazard insurance regulations and policy statements from eight to three and results in a net reduction of more than five pages of CFR text. As proposed, OTS has removed in their entirety five unnecessary, duplicative and outdated regulations and policy statements: § 545.126 (referral of insurance business), § 556.16 (insurance agencies – usurpation of corporate opportunity), § 563.35 (restrictions involving loan services), § 563.44 (loans involving mortgage insurance) and § 571.4 (hazard insurance). The remaining three provisions -- loan procurement fees, conflicts of interest, and corporate opportunity -- will be retained in the form of regulations, but streamlined and clarified.

OTS's objective is to reduce regulatory burden on savings associations to the greatest extent possible consistent with statutory requirements and safety and soundness. In the context of conflicts of interest, corporate opportunity and hazard insurance, we believe maximum burden reduction can be achieved by pursuing three specific objectives.

First, we are attempting to eliminate duplication and overlap. For example, the policy statement regarding hazard insurance (§ 571.4) has been largely superseded by the Interagency Real Estate Lending Guidelines.³ Similarly, the regulatory provisions prohibiting a savings association from conditioning the extension of credit on the borrower obtaining certain other services from the institution (tying arrangements) (§ 563.35) have been superseded by tying prohibitions in section 5(q) of the Home Owners' Loan Act of 1933, as amended (HOLA).⁴ Additionally, the regulatory provisions governing kick-backs and unearned fees for loans (§ 563.40) are largely duplicative of the Real Estate Settlement Practice Act of 1974 (RESPA)⁵.

Second, as part of its reinvention effort, OTS is seeking to move away from regulations that micromanage thrift operations. Accordingly, today OTS is repealing in their entirety detailed regulations concerning when federal thrifts can refer customers to affiliates that sell insurance, leaving insurance referrals to be handled in the same way as other corporate opportunity issues.

Third, in its reinvention effort, OTS is seeking to enhance the conciseness and clarity of its regulations. Accordingly, each of the three final rules has been redrafted

³ Formerly, Appendix A to Subpart D of Part 563, recodified without change as, Appendix to § 560.101 (61 FR 50951, 50978-81 (September 30, 1996)).

⁴ 12 U.S.C. 1461, *et seq.*

⁵ Pub. L. 93-533, 88 Stat. 1724 (1974).

using plain language techniques pioneered by the Department of Interior and promoted by the Reinvention Initiative.

In summary, OTS believes that regulations should generally be limited to essential safety and soundness requirements. If regulations are unnecessarily detailed and rigid, regulated entities may find themselves unable to respond to market innovations. Today's final rule achieves what OTS believes is the right balance by placing key safety and soundness requirements in binding regulations and putting more expansive guidance on prudent practices in the Thrift Activities Regulatory Handbook.

II. Summary of Comments and Description of the Final Rule

A. General Discussion of the Comments

The public comment period on the June 14 proposal closed on August 13, 1996. Ten commenters responded to the notice of proposed rulemaking. Four state and national trade associations, three federal savings associations, one law firm, one dual bank and savings and loan holding company, and one mortgage insurance corporation submitted comments.

All but three of the commenters generally supported OTS efforts to update and streamline its conflicts of interest, corporate opportunity and hazard insurance regulations and policy statements. Commenters commended OTS's proposed elimination of duplicative, overlapping and burdensome restrictions and indicated that the proposed modifications would give institutions greater flexibility in structuring

their operations. Commenters believed that the proposed changes would significantly reduce regulatory burden on the thrift industry and promote operational flexibility.

Several commenters raised concerns, however, that the proposed conflicts of interest and corporate opportunity regulations were unclear and failed to give meaningful guidance about what practices were prohibited. Commenters also expressed concern that OTS's intended approach for dealing with corporate opportunity within a holding company structure was only to be part of guidance and not included in the regulatory text. In response, OTS has refined the language of the rules and provided examples in the preamble to clarify the scope of the provisions. These concerns and OTS's responses are addressed in detail in the description of the final rules.

A few commenters expressed concern over the elimination of the hazard insurance provision allowing thrifts to force-place insurance and to reject policies that would provide inadequate protection to the institution. They agreed with OTS's view that these were matters of general safety and soundness principles with respect to lending practices, but believe that thrifts would be in a weaker bargaining position with borrowers if these provisions were removed. These concerns are discussed in detail below in the section-by-section analysis in reference to §§ 563.35 and 571.4.

B. Section-by-Section Analysis

1. Conflicts of Interest

Section 563.35 Restrictions Involving Loan Services

OTS proposed deleting paragraph (a) of § 563.35, which enumerates specific services typically involved in real estate lending that cannot be "tied" to the granting of a loan. OTS received no comments on this paragraph, which is duplicative of HOLA section 5(q). The paragraph is deleted as proposed.

OTS proposed to remove paragraph (b) of § 563.35, which requires a savings association to inform borrowers of their right to freely select providers of insurance services (e.g., hazard and mortgage insurance) and paragraph (c), which provides that a savings association may refuse to make a loan if the borrower's choice of insurance services would provide insufficient coverage.

OTS received no comments on paragraph (b). One commenter urged OTS to retain paragraph (c) to protect thrifts from having to accept insurance that provided insufficient coverage. OTS's significantly streamlined and revised lending rule⁶ sets forth the basic rules governing lending practices. Federal savings associations have the authority under these rules to refuse to make loans in the absence of adequate insurance coverage, with or without paragraph (c) of § 563.35. Coincident with this authority, borrowers must be provided the right to freely select insurance carriers, within the parameters established by the savings associations as necessary to meet their

⁶ 61 FR 50951, 50971 (September 30, 1996), to be codified at 12 CFR Part 560.

legitimate business needs and consistent with applicable law. Although the commenter noted that legislation had been proposed in at least one state that would prohibit a lender from refusing to accept a hazard insurance policy from any insurer admitted in the state and selected by the borrower, OTS's revised lending rules contain a detailed provision addressing preemption of state laws relating to lending practices.⁷ The states cannot force federal savings associations to accept insurance coverage that the associations deem inadequate. Accordingly, for the reasons set forth above and in the preamble to the proposed rule, paragraphs (b) and (c) are deleted as proposed.

OTS proposed to delete paragraph (d) of § 563.35, which provides that a savings association must give residential borrowers a written itemization of fees in excess of \$100 to be paid by the borrower for the lender's attorney. OTS received no comments on this paragraph, which is removed as proposed. Instead these settlement practices of savings associations will be governed by RESPA.

Section 563.40 Restrictions on Loan Procurement Fees, Kickbacks and Unearned Fees

OTS proposed retaining in modified form paragraph (a) of § 563.40, which prohibits certain persons from receiving any fee in connection with the procurement of a loan from the association or a subsidiary of the association. After considering the

⁷ 61 FR at 50972, to be codified at 12 CFR 560.2.

comments received, which are discussed below in Part II.C., OTS has decided to retain this paragraph with some technical corrections from the proposed rule, as new § 560.130.

OTS proposed deleting paragraph (b) of § 563.40, which prohibits the payment of unearned fees for loan origination and settlement services. This provision overlaps RESPA. OTS received no comments on this paragraph, which is removed as proposed.

Section 563.44 Mortgage Insurance

OTS proposed to repeal § 563.44, which prohibits a savings association (or service corporation affiliate) from insuring any loan with a mortgage insurance company if certain affiliations are present.

One commenter noted that it is appropriate to eliminate this provision because consumers are adequately protected by RESPA and the regulations promulgated thereunder, and conflicts of interests would be covered by existing law. Another commenter asserted that allowing thrifts to invest in mortgage insurance companies would create a conflict of interest that poses a risk to the safety and soundness of the thrift.

As indicated in the preamble to the proposed rule, OTS believes that common law fiduciary duties, the statutory rules governing transactions with affiliates, and OTS's new conflicts of interest regulation are adequate to address any conflicts of

ATTACHMENT IS AVAILABLE UPON REQUEST

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