



**Comptroller of the Currency
Administrator of National Banks**

Washington, DC 20219

**Interpretive Letter #785
June 1997
12 U.S.C. 3801
12 C.F.R. 34**

June 3, 1997

[]

Re: [], Inc./Shared Appreciation Mortgage Loans

Dear []:

This is in response to your April 29, 1997 letter to William B. Glidden, Assistant Director, regarding [], Inc. (“A”)’s plan to establish a program to purchase and securitize shared appreciation mortgage (“SAM”) loans made by certain lenders. According to your letter and our related telephone conversations, the lenders would include state banks. In connection with that program, [A] seeks to confirm that SAM loans made by state bank lenders in conformity with the OCC’s regulations on adjustable-rate mortgages would be subject to the coverage of the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. § 3801 et seq. (“Parity Act”). In particular, [A] wishes to confirm that a SAM loan is within the scope of the definition of an “adjustable-rate mortgage” under the OCC’s regulations implementing the Parity Act.

Facts

Each SAM loan would be a closed-end loan secured by residential property and would bear a stated fixed or adjustable rate of interest that would be payable periodically throughout the life of the loan. Each loan’s stated interest rate would be established at a rate below the market rate for comparable non-SAM loans, in return for the borrower’s agreement to make a final interest payment calculated as a percentage of the appreciation in value of the underlying property. Since this figure would not be determined until the conclusion of the loan term and final payment, the actual rate of interest paid by the borrower would be different from the stated rate of interest paid during the life of the loan.

Congress stated in the Parity Act its finding that the OCC (as well as the National Credit Union Administration and the Office of Thrift Supervision) had “recognized the importance of alternative mortgage transactions and [had] adopted regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing.” 12 U.S.C. § 3801(a)(3). It then declared that the purpose of the Parity Act was to:

“eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies. 12 U.S.C. § 3801(b).

In enacting the Parity Act, Congress signified its intention to preserve competitive equality between federal and nonfederal housing creditors by preempting state laws that banned state-chartered lenders from making certain types of nontraditional mortgage loans.¹ The Parity Act authorizes state banks and certain other nonfederal entities to make, purchase, and enforce qualifying alternative mortgage transactions as long as the state entities comply with federal regulations applicable to their federal counterparts. State banks are authorized under the Parity Act to engage in “alternative mortgage transactions,” but only when made in accordance with OCC regulations governing similar transactions by national banks. 12 U.S.C. § 3803(a)(1). State banks are further authorized to engage in such transactions “notwithstanding any State constitution, law, or regulation.” 12 U.S.C. § 3803(c).

The Parity Act defines “alternative mortgage transaction” to include a wide variety of mortgage loans containing features “not common to traditional fixed-rate, fixed-term transactions, including without limitation, **transactions that involve the sharing of equity or appreciation[.]**” 12 U.S.C. § 3802(1)(C) (emphasis added).

The OCC’s regulation implementing the Parity Act, entitled “Adjustable-Rate Mortgages” and published at 12 C.F.R. Part 34 Subpart B (the “ARM Regulation”), states that “[p]ursuant to 12 U.S.C. § 3803(a), a State chartered commercial bank may make [adjustable rate mortgages] in accordance with the provisions of this subpart.” 12 C.F.R. § 34.24.

Discussion

A SAM loan is a loan secured by an interest in real estate in which the borrower agrees to pay, in addition to principal and a stated rate of interest, an amount equal to an agreed percentage share in the net appreciation of the property. The OCC has approved the use of this type of loan by national banks, subject to certain limitations to ensure that the bank’s role in providing such financing is that traditionally assumed as a lender. OCC Interpretive Ruling

¹One federal court has explained the purpose of the statute as follows:

“The Parity Act represents a congressional response to a concern, amongst others, that State bans on mortgages other than traditional fixed-rate mortgages would reduce the overall availability of mortgage credit, since fixed-rate mortgages had become relatively more expensive as the result of increased interest-rate volatility.” Grunbeck v. Dime Savings Bank of New York, F.S.B., 74 F. 3d 331, 343 (1st Cir., 1996).

7.7312, 12 C.F.R. § 7.7312.² As noted above, the Parity Act explicitly includes shared appreciation mortgages within the scope of the statute.

Your request for confirmation that such a loan is within the scope not only of the Parity Act, but of the OCC's ARM Regulation thereunder, is prompted by the fact that the regulation uses a different term than the statute for the various transactions covered. The Parity Act refers to "alternative mortgage transactions," whereas the ARM Regulation, although adopted pursuant to the Parity Act, uses the term "adjustable rate mortgages" throughout its text. Moreover, the definition of adjustable rate mortgage in the regulation, unlike the statute, does not specifically refer to transactions that involve the sharing of appreciation.³

The use of the term "adjustable rate mortgage" instead of "alternative mortgage transaction" in the OCC's ARM Regulation does not in any way exclude SAM loans from the regulation's coverage. First, although the regulation, unlike the statute, does not specifically refer to shared appreciation transactions, the definition of "adjustable rate mortgage" would cover a SAM loan. An adjustable rate mortgage is defined to include mortgages where the lender "may adjust the rate of interest from time to time." 12 C.F.R. § 34.24. Since the rate of interest on a SAM loan is adjusted at the conclusion of the loan's term when the amount of the final payment is determined based upon the appreciation in value of the underlying property, a SAM loan is properly characterized as an adjustable rate mortgage.

In addition, the reason for this difference in terminology between the Parity Act and the ARM Regulation is explained in the preamble to the regulation itself. In the preamble, the OCC noted that one commenter to the proposed version of the regulation had "suggested that the OCC should expand the definition of 'ARM loan' to be consistent with the definition of 'alternative mortgage transaction' found in the Alternative Mortgage Transaction Parity Act... [citation omitted]." 61 F.R. 11294, 11296.⁴ The reason for the suggestion was to extend the scope of the regulation to home equity loans. The OCC rejected this suggestion, stating that

²See, e.g., OCC Interpretive Letter No. 620 (July 15, 1992), reprinted in [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,502; and OCC Interpretive Letter No. 204 (June 17, 1981), reprinted in [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,285.

³The OCC's ARM Regulation defines an adjustable rate mortgage as

"an extension of credit made to finance or refinance the purchase of, and secured by a lien on, a one-to-four family dwelling, including a condominium unit, cooperative housing unit, or residential manufactured home, where the lender, pursuant to an agreement with the borrower, may adjust the rate of interest from time to time. An ARM loan does not include fixed-rate extensions of credit that are payable at the end of a term that, when added to any terms for which the bank has promised to renew the loan, is shorter than the term of the amortization schedule." 12 C.F.R. § 34.20.

⁴The OCC published its notice of proposed rulemaking to revise subparts A (General), B (Adjustable Rate Mortgages) (ARMS), and E (Other Real Estate Owned) (OREO) of 12 C.F.R. Part 34 on July 7, 1995. 60 F.R. 35353. The final regulations were published on March 20, 1996. 61 F.R. 11294.

the ARM Regulation had historically been confined to home-purchase loans and did not cover other types of loans, including home equity loans.⁵ *Id.* The preamble further noted that “[w]hile the OCC’s ARM lending rule does not authorize home equity lending, such lending clearly is permissible under 12 U.S.C. [§] 371...” 61 F.R. 11294, 11296. The OCC thus clarified in the regulation’s preamble that its reason for rejecting the suggestion to use the same term -- “alternative mortgage transaction” -- as appears in the Parity Act was to confine the scope of the regulation to home-purchase loans and exclude home equity lending, which is authorized under another statute.

Since SAM loans are clearly mortgage loans with a rate of interest that is adjusted at the conclusion of the loan’s term when the appreciation in value of the underlying property is determined, it is my view that they are included within the scope of definition of “adjustable rate mortgage” in the OCC’s ARM Regulation. Although the Parity Act’s reference to “transactions that involve the sharing of equity or appreciation” is not repeated in the regulation, the definition of “adjustable rate mortgage” in the later covers such transactions. There is therefore no conflict between the Parity Act and the ARM Regulation, both of which apply to SAM loans.

As noted above (supra at 2), a state bank is authorized under the Parity Act to make alternative mortgage transactions, but only when made in accordance with OCC regulations governing similar transactions by national banks. 12 U.S.C. § 3803(a)(1). Since a SAM loan falls within the definition of an “adjustable rate mortgage” under the OCC’s ARM Regulation promulgated under the Parity Act, it follows that a state bank would be authorized by the Parity Act to make a SAM loan that conforms to the requirements of the ARM Regulation, notwithstanding any state constitution, law or regulation. 12 U.S.C. § 3803(c); 12 C.F.R. § 34.21.

I trust this is responsive to your inquiry. Please contact me at (202) 874-5300 if you have any further questions.

Sincerely,

/s/

Sue E. Auerbach
Senior Attorney
Bank Activities and Structure Division

⁵In a footnote to the preamble, the OCC quoted from an earlier (1981) version of the ARM regulation:

“The intent of the [ARM] regulation is to improve the availability of mortgage funds for purchasing residential property and to provide protection to home purchases. The intent is not to regulate adjustable rate loans made for other purposes.” 61 F.R. 11294, 11296, n. 6, citing 46 F.R. 18932, 18935 (March 27, 1981).