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May 29, 2002

Chief Counsel's Office
Office of Thrift Supervision
1700 G. Street, NW
Washington, DC 20552



The Friendly Mortgage People

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Attention Docket No. 2002-17

Dear Chief Counsel:

I am writing regarding the proposed rulemaking captioned above. The primary concern that I have is the removal of prepayment penalties from the list of applicable regulations for state chartered housing creditors.

I believe the OTS has erred in many of its assumptions regarding this issue.

The greatest mistake is your assumption that the Alternative Mortgage Transaction Parity Act does not apply to credit that has a fixed term and fixed rate. Indeed, that is what was impaired at the time of the Parity Act's inception and therefore shows in the Findings section of the act. Arguably, that condition still exists today since we see a plethora of adjustable-rate, balloon and other alternative programs. The definition of an "alternative mortgage transaction" under 1(B.) and 1(C.) of the act clearly shows that Congress intended the act to cover certain fixed-rate, fixed-term loans that were not "traditional." It goes so far as to give an example of a non-traditional fixed-rate, fixed-term loan that would be considered an alternative mortgage. "...transactions that involve the sharing of equity or appreciation." Since the act provides for call or balloon features on fixed-rate mortgages in 1 (B.), one cannot possibly read 1(C.) without referring back to 1(B.). The wording is very clear in 1(C.) since it says "...any similar type of rate, **method of determining return**, term, repayment, or...". Notice that the word "or" is used, not "and" demonstrating that any method of determining return other than straight, fixed amortization is considered alternative. Some have insisted that since some fixed-rate mortgages have prepayment penalties they are "common." This can be disproved with existing data. To my knowledge, only thrifts are so bold as to charge prepayment penalties on fixed-rate, fixed-term mortgages. I challenge you to find even one percent of fixed-rate, fixed-term mortgages that have a prepayment penalty.

You also state under "Background" that the Parity Act applies to "...loans with any alternative payout features that vary from conventional fixed-rate, fixed-term mortgage loans...". It appears in the rule's own language that only "conventional fixed-rate" or in the words of Congress "traditional" loans were the intention of Congress to be excluded from the Parity Act. Thus a loan with a prepayment payout although fixed in rate and

term would be considered "non-traditional." Clearly, loans with prepayment penalties are non-traditional or non-conventional. The very meaning of the word "alternative" is "to make different, without an entire change." There can be little doubt that Congress intended that any mortgage that was different than what state law provided for but was allowable by regulation for a thrift should be available to state-chartered creditors. Therefore, I believe you should keep the list of regulations as applicable to mortgage loans generally rather than trying to cut various provisions that Congress fully intended to have parity.

In 1993, the OTS removed any restriction on prepayment penalties for thrifts. While it took three years, the OTS moved generally in line with the purpose of the Parity Act in 1996 by giving the same rights to all mortgage creditors. That purpose was "... to eliminate the discriminatory impact that those regulations have upon non-federally chartered housing creditors..." They go on to state that the vehicle chosen to achieve this was "...by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions..." as long as they conformed to what was allowable for a federally-chartered creditor. A loan with a prepayment penalty is every bit as distinctive an incentive as are balloons and equity sharing. You argue, OTS regulations "...were not adopted to enable thrifts to engage in alternative mortgage financing." By allowing prepayment penalties by regulation for thrifts, OTS created a form of alternative mortgage financing whether that was its intention or not. There was no choice in 1996 other than to allow the same rights to state-chartered creditors. OTS cannot easily hide behind the shell that its prepayment regulations are part of "...a broader regulatory scheme...". That claim could be made for all of its regulations as an attempt to negate the Parity Act.

OTS should note that the landmark case regarding prepayment penalties under the Parity Act, NHEMA vs. Face, the judge put very little weight on OTS' identification power and referred primary back to AMPTRA itself. He states, "It is undisputed that the regulations for making alternative mortgage transactions not only regulate the prepayment of interest, but also explicitly authorize the collection of prepayment penalties..."

OTS erred in 1996 by usurping authority to delineate without regard to Congress' intent which rules for mortgage lending were applicable to the Parity Act. As proposed, OTS should have simply have agreed that all of Part 560 is what Congress intended under the Parity Act. The NCUA has done exactly that; all of its lending regulations apply. OCC has done essentially the same thing, however they have also incorrectly interpreted AMTPA to only include adjustable-rate mortgages. It is irrelevant that NCUA rules prohibit prepayment penalties. If the OTS feels that they are inappropriate, they should be removed from their regulations as well.

OTS was charged with publishing provisions of their regulation that "... are inappropriate... for non-federally chartered housing creditors." OTS has failed to make a meaningful argument why prepayment penalties are "inappropriate." There are many reasons why they are appropriate. They create more funding in the market place, they lower upfront costs to borrowers, they create financial stability among lenders who are subject to frequent prepayment, they tend to reduce "flipping", they allow for lower start rates for adjustable rate products to name a few. OTS uses only the flimsy argument that they may "...facilitate predatory practices." Then under footnote 15, OTS says it has no comprehensive data on this. Senator Gramm searched long and hard for this data and only anecdotal incidents were found. Senator Sarbanes has been introducing studies that produce data which omits cogent facts and from which purely subjective conclusions are being drawn.

OTS believes federal thrifts operate under closer supervision. OTS states "Other types of housing creditors are not bound by these restrictions and have more latitude in their operations." Should that be true, which I seriously question, why would OTS abdicate what it believes to be "...a uniform system of... compliance rules nationwide..." in favor of what could be a less uniform and perhaps more liberal set of laws on a local basis? Why not simply write regulations for thrifts that cannot be abused? I am amazed at the claims of so-called consumer groups such as the ones from North Carolina (where bankruptcies have exploded thanks to new legislation there) who claim to represent millions. They certainly don't have millions of members. That is as audacious as my saying that lenders represent every consumer who gets a mortgage. If the comments from America's Community Bankers are indicative, it would seem that thrifts see this as an opportunity to remove competition. These thrifts seem to have little local enforcement nor a responsive local complaint unit. My experience has been that OTS has strict depositor regulations but quite lax lending enforcement.

As OTS and its member thrifts have learned, creating a sound lending environment requires mitigating risk. Reducing prepaids allows that mitigation. It will only be a matter of time before political pressure will remove thrifts' ability to charge prepaids if political pressure from a small minority can result in such massive retreat from the Parity Act. The effect will be to destabilize the thrift system. Meanwhile, consumers who want the benefits of a prepayment penalty will be left without appropriate lenders.

If the goal is to remove prepayment penalties from Subprime loans, I fear this rule will fail on two counts. First, six of the top ten Subprime lenders are banks or thrifts or own banks or thrifts. Thus, the rule will be meaningless to them. Secondly, Subprime lending is still a relatively new industry. Virtually everyone who has become involved in it, including thrifts, have suffered heavy losses. Many have declared bankruptcy. Nearly all of the recent gains in home ownership have been a result of Subprime lending. It seems extremely strange that OTS would endanger what President Bush has declared one of his top priorities, higher rates of homeownership.

Finally, this proposed rule violates the Unfunded Mandates Act. It is impossible to believe that this will not impact the private sector alone by more than \$100 million or more. The legal fees to reconsider the law and redraft documents in 50 states will probably exceed that.

There are several grievous errors regarding OTS's IRFA. Certainly an IFRA is required despite the NAAQS issue. OTS itself has been appointed the regulator of alternative loans under AMTPA. In *NHEMA vs. Face*, the judge agrees, "OTS continues to regulate prepayment penalties...". It has gone even further by grasping interpretive authority regarding AMTPA. OTS has estimated that only 6,300 firms would be considered small businesses who engage in real estate credit. The data is from Census information that contradicts HMDA reporting. The greatest error is that it omits mortgage brokers. They will be the most directly affected entities since they originate the majority of residential loans in the United States. From known figures, the small entities affected are at least 40,000 and possibly 50,000 not to mention the thousands of appraisers and title companies who will also see diminished revenues. It is little wonder that every major non-bank trade association, including the National Association of Mortgage Brokers, opposes this rule.

I strongly recommend that OTS rethink rewriting AMPTRA by regulation. I agree that OTS could improve the disclosure arena regarding prepays in its own regulations which would automatically put the same mandates on non-federally chartered lenders.

Sincerely,



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