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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

ATTENTION: DOCKET NO. 2002-17

To The Office of Thrift Supervision ("OTS"):

Reed Smith LLP is one of the nation's largest law firms with a substantial client base in the financial services industry. Among our clients are numerous mortgage companies that engage in home equity lending on a nationwide or multistate basis. These mortgage companies are "housing creditors" as that term is defined in the Alternative Mortgage Transaction Parity Act, 12 U.S.C. § 3801 et seq. (the "Parity Act"). As such, these mortgage companies regularly rely upon the Parity Act's preemptive authority in offering "alternative mortgage transactions" as defined in the Parity Act ("AMTs") to their customers. We are writing this letter to comment on the Notice of Proposed Rulemaking regarding Parity Act preemption issued by the OTS and published in the Federal Register on April 25, 2002, 67 Fed. Reg. 20468 (the "Notice"). For the reasons set forth below, we oppose adoption of this proposal.

Background. In the Notice, the OTS proposes to amend 12 C.F.R. § 560.220 (the "Parity Act Rule") to delete the prepayment penalty (12 C.F.R. §560.34) and late charge (12 C.F.R. §560.33) regulations from the list of regulations OTS identifies as "appropriate and applicable" to housing creditors making AMTs. Based on the Supplementary Information provided by the OTS with the Notice, it appears that the effect of this proposed amendment would be to subject "housing creditors" making AMTs to state law limits on prepayment penalties and late charges. We urge the OTS to reconsider this proposed amendment to the Parity Act Rule because (1) it directly conflicts with the express legislative purpose of the Parity Act to give state housing creditors parity with federal savings associations; (2) it will dramatically impede the ability of state housing creditors to offer AMTs on a competitive basis in the existing marketplace; (3) it will lead to less favorable pricing for consumers and reduced consumer choice; (4) by subjecting state housing creditors that operate on a nationwide or multistate basis to a

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nonuniform patchwork of state law, it will result in a significant compliance burden and increased exposure to litigation; and (5) it does nothing to deter so-called "predatory lending."

Proposal Conflicts With Legislative Purpose. The express purpose of the Parity Act is not only to facilitate AMTs, but more specifically to give non-federally-chartered institutions parity with federally-chartered institutions offering such transactions.[1] To accomplish this purpose, Congress divided state lenders into three categories and "paired" each of those categories with a federal lender counterpart. Specifically, all "housing creditors" other than state commercial banks and credit unions were paired with federal savings associations and authorized to make AMTs "in accordance with regulations governing alternative mortgage transactions as issued by the [Office of Thrift Supervision] for federally chartered [savings associations]...." 12 U.S.C. §3803(a).[2]

Indeed, in prior interpretative letters, the OTS has expressly recognized the importance of placing state housing creditors on a level playing field with federal savings associations when offering AMTs. For example, in 1996, the same year it adopted the current Parity Act Rule, the OTS issued an opinion letter stating that the Parity Act preempted a Wisconsin statute limiting prepayment fees on AMTs. OTS Op. Chief Counsel, 1996 OTS Lexis 19, April 30, 1996 (the "OTS Opinion"). A contrary interpretation, OTS noted, would undermine the purposes of the Parity Act. According to the OTS, "if state housing creditors were required to follow the Wisconsin Statute when making variable-rate loans, they would clearly be disadvantaged vis-a-vis federal thrifts-- the very result Congress intended to prevent. (emphasis added). This concern is no less true today.

In the Notice, the OTS discusses the different approaches to the Parity Act taken by the National Credit Union Administration ("NCUA") with respect to state-chartered credit unions and by the Office of the Comptroller of the Currency ("OCC") with respect to state-chartered commercial banks. However, it is important to note that, while there are certain differences in each of these agencies' approaches to the Parity Act, both the OCC and the NCUA provide state-chartered lenders with the same authority as their federal counterparts to impose late charges and prepayment penalties on AMTs. Thus, a state-chartered credit union or commercial bank making AMTs is only subject to state law limits on prepayment penalties or late charges in those circumstances where their federal counterpart cannot preempt such state law limits.

For example, under OCC regulations, national banks have the ability to preempt state law prepayment penalty limits on AMTs that meet the OCC's definition of "adjustable rate mortgages."

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[1] Specifically, 12 U.S.C. § 3801(b) describes the purpose of the Parity Act as follows: "It is the purpose of this chapter to eliminate the discriminatory impact that those regulations [authorizing federally chartered depository institutions to engage in alternative mortgage financing] 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."

[2] The two other categories of state lenders, state commercial banks and state credit unions, were paired with national banks and federal credit unions, respectively. Id.

12 C.F.R. §34.23. Since the OCC regulations applicable to adjustable rate mortgages apply to state commercial banks making AMTs that are "adjustable rate mortgages," state commercial banks can avail themselves of such preemption. 12 C.F.R. §34.24. However, for other AMTs which do not constitute "adjustable rate mortgages" within the meaning of the OCC regulations, while a state commercial bank would be subject to state law prepayment penalty limits on such AMTs, a national bank would similarly be subject to such state limits because the OCC provides no preemption for national banks from all state law prepayment penalty limits on AMTs.[3]

Thus, if the OTS were to adopt the changes proposed in the Notice, it would be taking an approach to the Parity Act that is at odds with the approach taken by the OCC and the NCUA. Unlike state commercial banks and credit unions who can charge prepayment fees and late charges on AMTs to the same extent as their federal counterparts, "housing creditors" could not charge prepayment fees and late charges on AMTs to the same extent as their federal counterpart.

The clear purpose of the Parity Act was to allow state housing creditors to make AMTs on the same terms as federal savings associations. For that reason, any effort to create differences in the terms on which housing creditors and federal savings associations can make AMTs would effectively amend the scope of the Parity Act's preemption. We respectfully submit that such a change can therefore only be properly accomplished through Congressional action.

Unfair Competitive Disadvantage. By designating federal savings associations as the federal counterpart of state housing creditors under the Parity Act, it is clear that Congress viewed federal savings associations as the marketplace competitors of state housing creditors. Indeed, this competitive relationship was specifically recognized by the OTS in the OTS Opinion which, as noted above, observed that subjecting state housing creditors to a state law prepayment penalty limits would severely disadvantage state housing creditors in their ability to compete with federal savings associations. Thus, by making state housing creditors subject to state law limits on prepayment penalties and late charges to which federal savings associations are not subject, the OTS' proposal would result in the same competitive disadvantage to state housing creditors which the OTS previously sought to avoid and which Congress expressly designed the Parity Act to avoid.

The reason for this competitive disadvantage arises from the risk reduction function served by prepayment penalties and late charges. Because a prepayment penalty provides the lender with protection against the lost future income that would result upon prepayment, a lender is generally able to offer an interest rate to a borrower who agrees to a prepayment penalty provision in his loan contract that is lower than the rate that borrower might otherwise receive. Similarly, by providing incentives for timely payment and recovery of costs associated with late payments, late charges also provide lenders with more flexibility in their loan pricing. Thus, because of their ability to impose prepayment penalties and late fees without regard to the state law limits to which the proposal would make state housing creditors subject, federal savings associations will be able to offer AMTs with rates and other cost features that are more advantageous than those which state housing creditors will be able to offer.

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[3] The OCC real estate lending regulations found at 12 C.F.R. Part 34 also provide no preemption of state late charge limits. Thus, while a state commercial bank making AMTs would be subject to such state law limits, a national bank would similarly be subject to such state law limits.

Rather than fostering competition on an even playing field, the effect of the proposal will be to reduce competition.

Less Favorable Pricing and Reduced Consumer Choice. By reducing competition in the marketplace for AMTs, the proposal will also disadvantage consumers. As noted above, prepayment penalties and late charges provide housing creditors with greater flexibility in loan pricing, allowing them to offer loans to consumers on more advantageous terms than the consumer might otherwise receive. The proposal will deprive consumers of these pricing options. In addition, because housing creditors will be unable to price AMTs competitively, the proposal is likely to increase the dominance of large institutional lenders in the AMT marketplace. These larger institutional lenders do not serve many of the communities currently served by housing creditors. The result will be a less competitive marketplace with fewer choices available to consumers.[4]

Costly, Risky and Inconsistent Legal Environment. Parity Act preemption also enables state housing creditors to offer AMTs on a nationwide or multistate basis with uniform terms and conditions. By eliminating significant areas of Parity Act preemption, state housing creditors would be forced to determine the treatment of prepayment fees and late charges in each state in which they operate and to create loan documents to comply with those provisions in each such state. To meet the compliance burden that will result, state housing creditors will have to incur significant costs. Such costs will further disadvantage state housing creditors in their ability to price AMTs competitively with their federal counterparts. Moreover, given the array and complexity of state laws with which they will be required to comply, state housing creditors will face an increased risk of litigation arising from offering AMTs. To avoid such risk, state housing creditors may limit their offering of AMTS, thus reducing the availability of AMTs to consumers.

No Cure For "Predatory Lending." The proposed amendments are not an effective means of addressing "predatory lending" concerns. As noted by the OTS in its Advance Notice of Proposed Rulemaking published in the Federal Register on April 5, 2000, 65 Fed. Reg. 17811, predatory lending can take a variety of forms, with the result that there is no single loan term or practice that is the hallmark of a predatory loan. Moreover, as the OTS suggested in its April 2000 proposal, borrower education can be a more effective way of combating predatory lending than prohibiting or restricting certain loan terms. 65 Fed. Reg. at 17814. Thus, predatory lending can only be effectively addressed on a comprehensive basis that considers all of the practices which can result in predatory lending and the need for borrower education rather than through an approach that isolates prepayment penalties and late charges.

This is particularly so given that prepayment penalties and late charges, rather than serving as hallmarks of predatory lending, often enable state housing creditors to better serve consumers. For example, instead of having to recoup the cost of late payments through higher interest rates charged to all of its customers, late charges allow a lender to shift the cost of late payments to its delinquent

[4] We note that AMTs are not limited to equity loans but can also include purchase money mortgage loans. Indeed, because AMTs offer the possibility of lower initial interest rates and monthly payments than non-AMT products, AMTs can be of particular benefit to first time homebuyers. Thus, by reducing the financing options available to first-time homebuyers, the proposal could make it more difficult for first time homebuyers to achieve homeownership.

borrowers. Similarly, as noted above, prepayment penalties can allow lenders to offer loans at lower interest rates than a borrower might otherwise be able to receive if a prepayment penalty could not be charged.

It is also important to note that Congress has already limited the ability of lenders to impose prepayment penalties on loans which Congress has viewed most likely to involve predatory practices. These loans are the so-called "high cost mortgage loans," which Congress sought to regulate through the Home Ownership and Equity Protection Act, Pub. L. 103-325, 108 Stat. 2160 ("HOEPA"), amendments to the Truth in Lending Act, 15 U.S.C. §1601 et seq. The HOEPA amendments are implemented through provisions of Regulation Z, 12 C.F.R. §226.1 et seq., which apply to all mortgage lenders, including state housing creditors. More specifically, §226.32(d)(6) and (d)(7) of Regulation Z establish conditions for and limitations on prepayment penalties in such high cost loans. Thus, practices regarding prepayment penalties which may be deemed predatory have already been addressed through a federal regulatory scheme that applies to all lenders. Moreover, the fact that such HOEPA regulations do not address or place any limits on late charges indicates that Congress did not view late charges as raising predatory lending concerns.

For the reasons set forth above, we oppose the proposed amendments to the Parity Rule contained in the Notice and urge the OTS to reconsider its proposal.. We appreciate your consideration of our comments on this important regulatory issue.

Respectfully submitted,

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