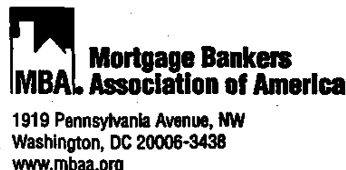

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June 24, 2002

260

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
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via email: regs.comments@ots.treas.gov

RE: Docket No. 2002-17
ALTERNATIVE MORTGAGE TRANSACTION PARITY ACT

Dear Sir or Madam:

Thank you for affording the *Mortgage Bankers Association of America* (MBA)[1] the opportunity to submit comments on the Office of Thrift Supervision's ("OTS") proposed changes to the regulations implementing the Alternative Mortgage Transaction Parity Act. (the "Parity Act").

BACKGROUND

In proposals issued on April 22, 2002, the OTS seeks to amend regulations implementing the Parity Act (12 CFR §560.220). The proposals would eliminate provisions covering late fees and prepayment charges from the list of provisions applicable to state-licensed housing creditors[2] that make alternative mortgage transactions under the Parity Act. The effect of the OTS proposal would be to limit the ability of housing creditors to access the benefits of federal preemption from state laws for late fees and prepayment charges.

Although the OTS does not recite a specific reason for engaging in proposed rulemaking to amend this regulation, we infer that it is linked to ongoing efforts by the

[1] MBA is a trade association representing approximately 2,900 members involved in all aspects of real estate finance. Our members include national and regional lenders, mortgage brokers, mortgage conduits, and service providers. MBA encompasses residential mortgage lenders, both single-family and multifamily, and commercial mortgage lenders.
[2] Under the Parity Act's definition, this term encompasses non-bank state-licensed lenders and state-chartered thrifts.

federal government to protect consumers from abusive mortgage lending practices. We commend the OTS for its ongoing efforts to end unscrupulous lending activities in the mortgage industry. MBA has been a consistent partner in these efforts, and our members will continue to assist state and local authorities in the important battle against predatory lending practices.

We submit, however, that this proposed rule will not, in any way, contribute to long-term efforts to ending fraud and abuse in lending. The persistence of the "predatory" lending problem is rooted in factors that need to be addressed through a fundamental reform of existing mortgage laws, a serious commitment to financial education, and very aggressive enforcement of existing laws. We submit that attempting to strike at predatory lending through a dismantling of the provisions of the Parity Act is an imprudent approach that is sure to lead to detrimental market effects in the form of decreased consumer choice and less market competition.

In short, MBA believes that razing the preemption privileges under the Parity Act will--

- create significant competitive inequities;
- complicate compliance burdens;
- make it impractical for creditors to offer alternative mortgage products;
- reduce market competition;
- eliminate consumer choice; and
- raise the cost of mortgage credit.

Our comments are set forth below.

STATUTORY OBJECTIVES

The intent of the Parity Act is to place non-federally chartered housing creditors on a level playing field (i.e., in "parity" with) federally chartered institutions in being able to assert preemption privileges from state laws in the making, purchasing, or enforcing of alternative mortgage transactions. The congressional objectives of the Parity Act are widely read as having two parts. First, Congress intended to eliminate the discriminatory impact that local laws have upon non-federally chartered institutions. Second, Congress intended that there be an affirmative granting or conferring of parity status to non-federally chartered institutions.[3] This twofold congressional intent can be gleaned from the act's plain language as well as its statutory history.[4]

The Parity Act thus reflects the legislative intent to encourage competition in the alternative mortgage market, and to ensure that non-federally chartered institutions are not to be hampered by provisions that do not apply to federally chartered institutions.

[3] *See* 12 USC § 3801(b) (stating that the primary purpose of the Parity Act is to "eliminate the discriminatory impact that those regulations have on nonfederally chartered creditors and provide them with parity with federally chartered institutions... " (emphasis added)).
[4] *See* Id., Sen.Conf.Rep. No.97-641 at 94 (reprinted in 1982 U.S.C.C.A.N. 3128, 3137) (Congress points out that the Act authorizes "non-federally chartered housing creditors to offer alternative mortgages in accordance with the Federal regulations issued by the appropriate Federal regulatory agencies. Thus, those creditors will have parity with federally chartered institutions.")

The very premise of the law is that non-federally chartered institutions should be allowed to operate under the same legal and regulatory regime as federally chartered institutions. Pursuant to this congressional intent and purpose, the Act requires that OTS adopt policies and implementing regulations that do not have the effect of benefiting federally chartered institutions over other types of institutions.

MARKET EFFECTS

Currently, non-federally chartered lenders are able to compete on a "level playing field" with federally-chartered institutions in large part because of the provisions of the Parity Act. By complying with strict federal rules under OTS regulations, non-federally charted creditors can be relieved from varying, complex, and discriminatory state laws and regulations. This is important because the reality of today's economy is that mortgage lending is conducted on a truly national scope. Creditors are increasingly engaging in interstate lending activities, achieving important economies of scale thanks to nationwide operations. A further significant trend, and one that is directly linked to the surge of the "national" mortgage market, is that mortgage lending is heavily dependant on capital flows from secondary mortgage capital markets. This is very much the case for the subprime sector of the market, where a robust secondary market for subprime loans provides the necessary liquidity for alternative mortgage products, while reducing costs and expanding the availability of all types of loans.

We note, however, that the secondary market depends greatly on legal certainty and predictability in terms of applicable rules and regulations. A standardized set of laws, therefore, provides them with the very necessary uniformity that ensures enforceability of particular transactions and also facilitates securitization. This is especially true in the subprime market with respect to alternative mortgage products. It is well observed that since the enactment of the Parity Act, the secondary market has had a major role in flowing funds to finance alternative mortgage products. This continued and growing flow of capital comes, in no small part, because the standardizing effects and the legal and regulatory confidence inculcated by the provisions of the Parity Act.

The Parity Act, by authorizing non-federally chartered institutions to "purchase and enforce" alternative mortgage transactions on equal terms as federally chartered institutions, places much needed order and standardization to secondary market operations. This standardization, in turn, allows for the efficient flow of funds from secondary market investors.

OTS PROPOSAL

Under the proposed rule, the OTS seeks to eliminate the preemption granted by the Parity Act for late charge and prepayment fee provisions. This is a very significant regulatory action. Prepayment fees and late charge provisions serve as extremely important risk-control tools that mortgage lenders employ for the purpose of tailoring loans to specific consumer needs.

Prepayment fees, for example, allow lenders to hedge the risks of early loan repayment, and thus control losses where the debt is repaid in advance of projections and prior to the lender being able to recover costs and expenses. This is a very practical option that has concrete pricing implications for borrowers. In effect, a prepayment fee allows a consumer to choose a loan with a lower interest rate in exchange for a prepayment fee feature. Said differently, it allows a lender to "cut" the rate on loans by imposing a conditional fee (and one that may never have to be paid by the consumer at all). Through this mechanism, borrowers are afforded options with real price implications—prepayment fees may potentially reduce rates by 25 to 100 basis points or more. Depending on the consumer's personal circumstances, this option may make the difference between an affordable and a non-affordable loan.

Similar arguments apply to late charges. As stated by the OTS proposed rule, the ability to impose late fees "encourage[s] the timely payment of loans," as well as the recovery of "costs associated with late payments."[5] As such, these charges are effective tools that encourage timely monthly payment, and serve to offset the costs incurred by tardy payments. From a lender's perspective, late fees create very identifiable efficiencies in terms of loan servicing and administration, which in turn translate into increased profits for lenders and/or lower costs for consumers.

Under the OTS proposal, federal preemption would be lifted from these prepayment and late fees. The proposal would therefore allow state laws to intrude and govern these terms for non-depository housing creditors. State and local restrictions that apply to these tools are often complex and diverge greatly from state to state. In some states, these terms must be accompanied by rigid disclosures. In other localities or local municipalities, these terms may be altogether prohibited. In light of these widely divergent state laws and regulations, we offer then following critiques on this proposal—

- *Competitive Inequities*

As set forth above, it is a market reality that prepayment fees serve an important role in controlling for very significant lender/investor risk. Prepayment fees are a very common feature in alternative mortgage loans, and are, plain and simple, a determining component in the pricing of alternative mortgage loans.

The proposed rule therefore misses a fundamental point in suggesting that "the impact of the loss of prepayment penalties may be ameliorated somewhat through other techniques." Though technically accurate, this statement assumes that it is economically neutral to compensate for prepayment fees by charging higher points or increase rates. We point out that it is <u>not</u> impartial or neutral to force only certain lenders to raise their product price. The very core of our objection to this proposal is that it creates artificial "disparities" among different market players. Through the removal of sections 560.33 and 560.34 from the provisions designated as applicable the Parity Act privileges, federally-chartered institutions will be afforded outright preferential treatment in the form of a special, and very valuable, standard exemption from state

[5] 67 FR 20468, 20470.

prohibitions. In short, this action amounts to an exclusive "license" to use prepayment fees free of local restrictions, and such "license" will result in federally chartered institutions alone having the ability to offer loan products at discounted prices *vis-à-vis* other creditors.

- *Complications in Compliance*

It is very important to note that eliminating the preemption privileges for non-federally chartered members will substantially complicate compliance burdens for affected institutions. States impose a wide array of prohibitions and varying requirements on mortgage lenders. The hodgepodge of state-mandated disclosures and/or restrictions create very burdensome regulatory variations for interstate lenders that are extremely expensive to implement. The complex web of legal and administrative requirements adds a very substantial amount of legal risk that must be managed through layers of internal controls and audits. The OTS should recognize that these burdens are of great import as they translate into very real operational advantages for those institutions that are entirely exempt from compliance with state laws. In the current regulatory environment, multi-state lenders are finding it prohibitively expensive to keep pace with the dizzying changes at state and local levels. The removal of preemption privileges, therefore, effectively construct very high competitive barriers for non-federally chartered institutions that are forced to struggle through the growing tangle of regulatory requirements.

Nor can we ignore the compliance question in terms of secondary market response. In this sense, we note the significant confusion that would arise for purposes of purchasing and enforcing mortgage loans if federally chartered banks and non-federally chartered creditors operated under entirely different laws. In such an environment, secondary market operations would be in disarray as questions of compliance and enforceability would drown efficient flows of mortgage capital. Secondary market players would be required to undertake extensive, and costly, due diligence analysis, reach detailed conclusions relating to specific loan originations as part of an expanded due diligence process, and implement costly operating systems to comply with varying laws. Secondary market players also may be forced to establish separate pools for mortgage loans originated by federally-chartered creditors and non-federally chartered creditors, which would further increase costs and operational burdens. The increased costs and operational burdens would lead directly to higher rates and fees on loan products.

- *Obstruction to Alternative Mortgage Products*

As mentioned elsewhere in these comments, prepayment fees are important controls for the very significant risk of early repayment. In light of varying risk/loss tolerances of different market players, it is fundamental that at certain risk levels, certain lenders will not be willing to extend credit without the security of a prepayment fee. Allowing restrictive state regulation to hamper creditors' ability to hedge risk through the prepayment fees will, in virtually every instance, reduce the number of adjustable rate and other alternative mortgage loans that would otherwise be made, if not cause many

lenders to cease offering the products altogether. This would be a disservice to consumers, especially many first-time homebuyers who use attractively priced adjustable rate and balloon mortgage loan products to enter the housing market.

In many instances, prepayment fees are downright prohibited under state law. In such instances, a non-federally chartered institution would not be able to make that loan at all, regardless of whether or not that creditor followed the protective OTS provisions for such terms, because under this proposal, preemption is removed.

- *Elimination of Market Competition*

The proposals advanced in this rulemaking are very likely to elicit a market response that will be very damaging to industry competition. In light of the competitive and regulatory elements described above, foreclosing creditors' access to federal preemption will materially affect operational costs and directly impact the ability and/or willingness of non-federally chartered institutions to offer alternative mortgage products throughout all markets. This will lead federally-chartered institutions to face less competitive pressures, and ultimately cause higher prices and a decrease in consumer choice overall.

- *Results: Elimination of Consumer Choice and Constriction of Credit*

As mentioned above, the very purpose of the Parity Act is to eliminate the discriminatory impact occasioned by state laws, and provide them with parity with federally-chartered thrifts. This was meant to spark competition in the market, and ultimately, increase mortgage loan options and decrease costs. The effects of this proposal would be exactly the opposite. We strongly believe that this proposal will impose heavy regulatory burdens, competitive barriers, and pricing disadvantages to non-federally chartered creditors. This imbalance will eliminate a significant number of lending institutions from the market, as many lenders will be unable to access the advantageous pricing benefits of prepayment fees. Other non-federally chartered institutions would continue to operate, but would not offer the array of choices or the pricing options afforded by prepayment fees. Either way, consumers suffer in terms of an overall decrease in credit options.

Secondary market effects are sure to have a further credit constricting effect. In light of the certainties demanded by the secondary markets, any tinkering with the Parity Act regulations will depress investor appetite for alternative mortgage products. As a result, there will be fewer alternative mortgage products in the market.

INADEQUATE RULEMAKING RECORD

In light of the comments set forth above, we urge that the OTS take pause and reconsider any changes to Parity Act regulations. Responsible rulemaking must be based on a sound administrative record. It appears, from the preamble materials that accompany the proposed rule, that the OTS has not considered the entire range of

elements that could be affected by the proposal. As stated above, compliance costs, competitive inequities, legal risks, are all factors that together will significantly reduce the availability of alternative mortgage credit in the market.

We note that in the preamble to the proposal, the OTS admits that it "does not collect information on housing creditors that take advantage of the Parity Act." This statement alone dictates that OTS take pause—the agency should not be amending important regulatory provisions without a fuller understanding about the entities that it is affecting. The OTS goes on, however, to explain that "OTS sought data on the extent to which housing creditors taking advantage of the Parity Act are engaged in predatory practices and the effect that the Parity Act has on the availability of credit." The OTS further explains that "[w]hile commenters offered anecdotal information, OTS received no comprehensive data in response to the ANPR."

These explicit statements by the agency confirm the absence of any express findings that justify the move to limit the provisions of the Parity Act. The OTS should not be advancing in light of minimal anecdotal information. The issues of subprime and predatory lending are particularly ill defined and driven by anecdote, as opposed to sound, market-wide information. MBA shares in the concerns about reports of abusive lending practices and is committed to eliminating all unscrupulous lending activity. We are not aware of any comprehensive report that in any way demonstrates that the Parity Act regulations are being used to defraud or abuse consumers. We are very concerned that aimless and ungrounded regulatory action will lead only to the negative ramifications of constricting credit supply in the subprime sector of the market. As we have argued before, subprime lending has served as a source for loans for a portion of the market that is very much in need of credit options. In crafting solutions for the problem of abusive lending, regulators must advance thoughtfully and carefully to assure that additional rules promote, rather than restrict, credit extension.

MBA strongly recommends that OTS gain a more thorough understanding of the subprime market and the entities it is affecting <u>before</u> moving forward with any rulemaking.

PROPAGATION OF STATE LAWS

It is no mystery that there is currently an unprecedented level of state and local activity regarding mortgage lending. This proliferation of local, state and federal laws covering specific mortgage terms and conditions has created the very somber reality that financial institutions are finding it extremely difficult and expensive to formulate models for compliance in one geographic location without the high probability of falling out of compliance in a different locality. In fact, the unending passage of so-called "predatory lending" laws at local levels is creating a situation where multi-state lenders are no longer able to comply with the full barrage of local rules and requirements that are being enacted. The negative impact of this regulatory fragmentation at the state level is causing lender flight from certain states and municipalities, and generating an

unprecedented level of discussions regarding the possibilities of standardizing the legal framework covering mortgage lending.

We ask that the OTS recognize that in this charged political environment, these proposals are likely to have a very negative impact in terms of incentivizing yet additional state and local activity. We respectfully submit that if the OTS acts to finalize a rule that limits preemption, it will inadvertently send out a strong message to states and localities that OTS is "ceding" regulatory authority over alternative mortgage products. In light of the underlying stance of the previous Parity Act issuance[6] implying that the OTS Parity Act regulations hamper states in their effective regulation of state housing creditors, we strongly believe that some may misinterpret the current regulatory initiative. The public "messages" that could be perceived by this rulemaking are, first, federal oversight over creditors is ineffective, and perhaps even improper, and second, that state legislatures should continue to enact even more restrictions and prohibitions to more tightly regulate alternative mortgage products.

We ask that OTS recognize and fully consider the political hazard in inadvertently promoting such an erroneous message through this rulemaking activity.

CONCLUSION

Consistent with its intent, the Parity Act has greatly contributed to robust competition that has directly benefited borrowers in lowering the cost of credit and stimulating the creation of alternative mortgage products that fit the special needs of each consumer. Eliminating access to preemption would only reintroduce the very market inequities that Congress meant to eliminate through the enactment of the Parity Act; market inequities will, in turn, reduce market competition and consumer choice. The costs and complications involved in complying with at least 51 different laws regarding one single loan term will lead many creditors to altogether refrain from making alternative mortgage loans, thus reducing options for borrowers with special needs.

MBA appreciates the opportunity to comment on this very important issue. We would welcome the opportunity to discuss these comments further or answer any questions the OTS may have on our members' views on this issue. If there are any any questions about the foregoing, please feel free to contact Rod J. Alba, Director of Regulatory Affairs, at 202/557-2930.

Thank you for your consideration.

Sincerely,

Kurt Pfotenhauer
Senior Vice President
Government Affairs

[6] Advance Notice of Proposed Rulemaking, "Responsible Alternative Mortgage Lending" (12 F.R. 17811 (April 5, 2000))