

THE FINANCIAL SERVICES ROUNDTABLE



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Regulation Comments
Office of Chief Counsel
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

Re: Docket No. 2002-17

Dear Sir or Madam:

The Financial Services Roundtable ("The Roundtable") appreciates the opportunity to provide its comments to the Office of Thrift Supervision on its notice of Proposed Rulemaking regarding its rules under the Alternative Mortgage Transaction Parity Act (the "Parity Act"). The Proposed Rulemaking was published in the *Federal Register* on April 25, 2002.

The Roundtable is a national association representing 100 of the largest integrated financial services firms providing banking, insurance, and investment products and services to American consumers. Many Roundtable members make mortgage loans on a nationwide basis. Our members strongly support competitive mortgage markets and fair regulation of mortgage products as the best means to meet the needs of consumers. The Roundtable believes that clear and predictable regulatory guidance under the Parity Act has enabled our members to deliver home mortgage credit through alternative mortgage transactions efficiently and at reasonable costs to consumers in a wide array of economic climates.

The Roundtable believes the Parity Act and the current Office of Thrift Supervision rules under the Parity Act at 12 C.F.R § 560.220 have been essential to accomplish these objectives. Accordingly, the Roundtable opposes the Office of Thrift Supervision's proposal to narrow the preemptive nature of its regulations governing alternative mortgage transactions under the Parity Act.

The Roundtable opposes the Proposed Rulemaking, because we believe it will have a material negative impact on important programs of many large nationwide mortgage lenders who originate mortgages across the credit spectrum, including those for less creditworthy borrowers (e.g. the subprime market). We also believe that the Proposed Rulemaking should not be utilized to attempt to control predatory lending since predatory lending (a practice that we have strongly and consistently opposed) is a complex issue which should be dealt with comprehensively and not on a piecemeal basis. Using this tool is an inexact approach and could exacerbate the problem.

The ANPR and its Relationship to Predatory Lending

The Office of Thrift Supervision's Proposed Rulemaking and the April 2000 Advance Notice of Proposed Rulemaking ("ANPR") contained detailed information regarding the passage of the Parity Act in 1982 and the evolution of the Office of Thrift Supervision Parity Act rules. It also discussed the problem of predatory lending and that the lending rules of the Office of Thrift Supervision "actively discourage" and not "inadvertently allow predatory practices by those who rely on our regulations"

The Roundtable has long supported appropriate restraints, laws and regulations to curb abusive predatory lending practices. Our position has been clear and consistent on that subject. We are pleased that the Office of Thrift Supervision, after requesting comment on the ANPR, concluded that there was no evidence linking the benefits of the Parity Act for state housing creditors to predatory lending practices. The absence of such a link was also noted by state banking regulators who, commenting on the ANPR, stated that they were "not aware of trends

suggesting any segment of the [mortgage] industry is more likely than another to engage in predatory lending practices”¹.

We condemn predatory lending and support measures to curb abusive lending practices, but urge a careful response in light of the important issues involved. We believe that the Proposed Rulemaking should not link the Parity Act to abusive lending practices, particularly since the Office of Thrift Supervision received no evidence linking the Parity Act to such practices.

Background of the Parity Act

When the Parity Act was enacted 26 states had restrictions or prohibitions on alternative mortgage transactions. By contrast, federal depository institutions operated under alternative mortgage transaction rules promulgated by the Office of the Comptroller of the Currency, the Office of Thrift Supervision (formerly the Federal Home Loan Bank Board) and the National Credit Union Administration.

The intent of Congress in the Parity Act was to eliminate the discriminatory impact of federal rules on state housing creditors. It did this by allowing federal rules covering alternative mortgage loans to be applied to state housing creditors, notwithstanding conflicting state laws.

The Parity Act Has Reduced Costs, Permitted Design Flexibility and Fostered Competition

Since enactment of the Parity Act and in some respects, because of the Parity Act, the mortgage market has changed dramatically. Alternative mortgage products have evolved to

¹ Letter of Comment of the Conference of State Bank Supervisors to the Office of Thrift Supervision dated July 5, 2000.

reflect market realities so that, even in times of credit stringency, terms and programs have been created to match consumer needs.

The Parity Act, as it has evolved under the Office of Thrift Supervision rules referenced in 12 C.F.R. § 560.220, has clearly impacted the growth, design and efficiency of alternative mortgages originated by state housing creditors. One of its principal benefits is that it has helped our members, who primarily lend on a nationwide basis, to reduce compliance costs. Clearly, it is far less costly to design and administer an alternative mortgage product that is modeled on a single set of federal rules, consistently applied, than one modeled on 51 or more unique state and local rules. The cost efficiency has been an important component of the Parity Act.

The Parity Act also has enabled state housing creditors to respond quickly and creatively to rapidly changing markets and economic conditions, as well as institute best practices in connection with subprime lending. For example, many lenders offer lower initial interest rates, including points, in exchange for borrowers' willingness to accept prepayment penalty clauses on adjustable mortgage loans. This, of course, has improved loan sale and securitization opportunities and also benefited borrowers through lower rates. Virtually all of the states have laws limiting or restricting prepayment penalties in some manner, but nationwide lenders generally need only look to the federal standard with respect to alternative mortgage loans. As a result, the borrower can shop for a product that meets his needs. Lenders can craft products with the preferences and specialized needs of the borrower in mind. Where, for example, lower initial rates are traded for an agreement to a prepayment penalty, borrowers benefit where it matters most, in lower borrowing costs. This economic benefit, as well as the flexibility and cost efficiencies, would not be available without the Parity Act rules.

The Parity Act also has fostered a competitive equality among state and federal lenders. Each operates under uniform rules on key components of alternative mortgages that are applied equally and interpreted consistently by the Office of Thrift Supervision. A strong mandate from

Congress and the historically strong defense of its preemptive authority, including the Parity Act by the Office of Thrift Supervision, also have deterred the initiatives of the States with respect to laws conflicting with the Parity Act rules of the Office of Thrift Supervision.² We believe that the important objectives of Congress in enacting the Parity Act to eliminate the discriminatory impact of federal regulations and preservation of the "essential" nature of alternative mortgage transactions have been achieved. The benefits have taken the form of cost efficiencies, equal competition and product design flexibility which we believe have given consumers choices and financial benefits in selecting mortgage products.

The Office of Thrift Supervision's Rationale for its Proposed Narrowing of Its Parity Act Rules

Notwithstanding the benefits of the Parity Act and the Office of Thrift Supervision rules thereunder, the Office of Thrift Supervision, for reasons that are not clearly developed, has proposed to eliminate the application of its late fee rule (§ 560.33) and its prepayment rule (§ 560.34) to alternative mortgage transactions of state housing creditors. It states that neither its late fee nor prepayment penalty rules under the Parity Act are alternative mortgage specific rules, but apply to all mortgage loans by federal associations. According to the Office of Thrift Supervision, the imposition of late fees and prepayment fees as "general restrictions" on all mortgage loans make the retention of late fee and prepayment fee rules unnecessary at the federal level.

² Two recent state law initiatives on prepayment penalties in Virginia (rejected by a Federal District Court) and Wisconsin (though an Office of Thrift Supervision opinion) have demonstrated the broad, preemptive impact of the Office of Thrift Supervision rules and the willingness of the Office of Thrift Supervision to defend its preemptive authority in the face of conflicting state laws. See *National Home Equity Mortgage Association v. Face*, 64 F. Supp., 584 (E.D. VA 1999) and the Opinion of Chief Counsel, Office of Thrift Supervision dated April 30, 1996.

We respectfully disagree with the Office of Thrift Supervision's approach. Apart from providing state housing creditors with much narrower Parity Act preemption than banks, credit unions and federal thrift institutions, the Office of Thrift Supervision appears to assume that state laws are both uniform and static. This is not the case. As noted above, the Office of Thrift Supervision Parity Act rules have been an important, perhaps crucial, element in producing compliance efficiencies so that from a nationwide lender's compliance perspective the laws are relatively uniform in fundamental areas such as prepayments and late fees. The Parity Act rules have also dissuaded states from targeted regulations on alternative mortgage transactions. Without the protection of the Parity Act rules, the late fee and the prepayment fee penalty provisions in Office of Thrift Supervision rules would be "fair game" in many states. A significant majority of the States (about 40 for late fees and 36 for prepayment penalties), already have laws governing late fees and prepayment fees. They could be applied to all loans or alternative mortgages. With regard to the latter, it would be a relatively simple matter to amend these laws or applicable regulations to cover alternative mortgage-related late fees and prepayment penalties for state housing creditors. That possibility is not an unrealistic one given the broad concern over predatory lending and the inference (see the ANPR) that the Parity Act may foster predatory lending (although the Office of Thrift Supervision indicated in a footnote to the Proposed Rulemaking that it had received no "comprehensive" evidence linking predatory practices to the Parity Act). The Parity Act has, to date, prevented the States from acting on this possibility with respect to alternative mortgage transactions. However, the changes as proposed may provide an attractive "rifleshot" opportunity to show action on predatory lending that may be difficult for state legislators or state regulators to resist. We urge the Office of Thrift Supervision to reconsider the Proposed Rulemaking in light of this discussion.

The Office of Thrift Supervision Has Limited Authority to Amend Its Parity Act Rules

The Roundtable also believes that as a legal and practical matter the Parity Act significantly limits the ability of the Office of Thrift Supervision to redefine the areas that the Act covers. The Parity Act, as a matter of law, requires that the discriminatory impact of federal rules on state housing creditors be "eliminated." It has, since enactment, achieved this objective. For example, under current rules, in an alternative mortgage transaction a state housing creditor could impose a late fee as authorized under § 560.220 of the Office of Thrift Supervision's rules even if state law prohibited late fees. State laws on late fees and prepayment penalties are preempted under the Parity Act because of their "discriminatory" impact on state housing creditors and specifically, since November 1996, because the Office of Thrift Supervision designated its late fee and prepayment fee rules as applicable to alternative mortgage transactions. We believe, however, that the Parity Act might require this result even if the Office of Thrift Supervision, did not specifically reference its late fee rules and prepayment rules (§ 560.33 and 560.34) as applicable to alternative mortgage transactions. There is no more compelling example of the discriminatory impact of federal rules than a rule that allows federal lenders to impose a late fee and prepayment fees in a state where state housing creditors were restricted from doing so because of state laws impacting alternative mortgage transactions. We note that the Office of Thrift Supervision itself concluded several years ago that the plenary authority under the Parity Act allowed preemption even where federal lending rules were not specifically identified as applicable to alternative mortgage transactions. In that instance, the Office of Thrift Supervision was asked to opine on whether a Wisconsin law restricting prepayment penalties for state housing creditors was preempted by the Parity Act. The Office of Thrift Supervision opinion found that the Wisconsin law was preempted even though the

prepayment rules of the Office of Thrift Supervision were not at that time specifically earmarked as applicable to alternative mortgage transactions. The opinion said,

“If state housing creditors were required to follow the Wisconsin statute when making variable rate mortgage loans, they would clearly be disadvantaged vis-a-vis federal thrifts -- the very result Congress sought to prevent.”³

As indicated above, this opinion was issued before the late 1996 revisions to the Office of Thrift Supervision Parity Act rules, and before the prepayment penalty regulation was specifically referenced in § 560.220. It is instructive because the Office of Thrift Supervision relied on the fundamental purpose of the Parity Act to end the discriminatory impact of federal laws on state housing creditors. If the Office of Thrift Supervision finalizes the rulemaking as proposed, it would have to reconcile its actions with its 1996 opinion that the Parity Act must apply when federal rules discriminate against state housing creditors. Should the Proposed Rulemaking be adopted and initiatives like Wisconsin’s resurface, we anticipate that numerous state housing creditors will request opinions from the Office of Thrift Supervision on the possible discriminatory impact of state laws under the Parity Act. These opinions will present difficult questions. The Office of Thrift Supervision may conclude, as we have, that the requirement to prohibit the discriminatory impact of federal rules limits its flexibility under the Parity Act and that the status quo is required unless Congress amends the Parity Act.

Guidance on Existing Mortgages

The Proposed Rulemaking could, if adopted, also present difficult contractual issues relating to the enforceability of mortgages issued under the Parity Act rules of the Office of Thrift Supervision *if state law restricts alternative mortgage transactions*. Generally, new rules or elimination of rules are not retroactive and lenders will assume the enforceability of existing

³ Opinion of the Office of Thrift Supervision’s Chief Counsel, April 30, 1996.

prepayment and late fee provisions related to loans made prior to the Proposed Rulemaking. However, borrowers might argue that the proposed rule change had a retroactive effect because the Office of Thrift Supervision was incorrect at the outset in preempting prepayment and late fee rules of the states since these rules are applicable to all loans and not just to alternative mortgages. The Office of Thrift Supervision's discussion in the preamble may give unintended support to this position in that it concluded there was "no basis" for distinguishing its late fee and prepayment rules from its general lending rules. Some of the loans impacted have been securitized or sold or are serviced by others. A number of parties, not just lenders are impacted and the enforceability of these provisions is a particular concern. Guidance on the continued enforceability and prospective nature of the new rules should be considered by the Office of Thrift Supervision if the Proposed Rulemaking is adopted.

Conclusion

The Roundtable thanks the Office of Thrift Supervision for the opportunity to express its views. The Roundtable has strenuously opposed abusive predatory lending practices but it does not believe that the Proposed Rulemaking is the appropriate vehicle to address these important issues. The Roundtable opposes the Proposed Rulemaking because it would increase costs, discriminate against state housing creditors and encourage the States to target or have the effect of targeting alternative mortgage transactions with costly and burdensome regulations. Finally, the Roundtable believes that the Parity Act mandates uniform national standards for the design of alternative mortgage products. These national standards should be in place before the potentially

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discriminatory impact, on state housing creditors, as permitted by the Proposed Rulemaking, is allowed to occur.

Yours truly,

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