



June 14, 2002

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: Docket No. 2002-17

Alternative Mortgage Transaction Parity Act; Preemption

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the proposal by the Office of Thrift Supervision (OTS) to rescind the pre-emption of state laws on prepayment penalties and late fees as they apply to state-chartered housing creditors.

Background

In 1982, Congress adopted the Alternative Mortgage Transaction Parity Act ("Parity Act") to help expand credit availability at a time of high interest rates. The intent was to make it easier for lenders to offer variable rate mortgages and other creative financing packages when those vehicles were often restricted by state laws. The Parity Act applies to any "alternative" payment feature on a mortgage, such as balloon payments, variable rates or call features. In essence, it pre-empts state law and allows state-chartered housing lenders to elect to follow OTS rules rather than state law.²

Currently, OTS regulations pre-empt state laws that apply to late charges, prepayment penalties, adjustments to rate and balance, and initial and change-in-term disclosures. Although many of the lenders that take advantage of the Parity Act are non-depositories and not subject to regular examination, a creditor must be licensed under applicable state law to take advantage of the Parity Act.

¹ ICBA is the primary voice for the nation's community banks, representing 5,000 institutions at more than 17,000 locations nationwide. Community banks are independently owned and operated and are characterized by attention to customer service, lower fees and small business, agricultural and consumer lending. ICBA's members hold more than \$511 billion in insured deposits, \$624 billion in assets and more than \$391 billion in loans for consumers, small businesses and farms. They employ nearly 231,000 citizens in the communities they serve.

² The Parity Act is not applicable to commercial banks, credit unions, or federal savings associations.

Since the Parity Act was adopted, many states have revised their laws to permit alternative mortgages and other forms of creative financing for home loans. However, as concerns about predatory lending have increased, consumer groups and state authorities have asked OTS to limit the Parity Act's application and thereby allow states more control. In contrast, some financial institutions, including state-chartered thrifts, argue that the Parity Act exemptions should be preserved to provide for uniform regulation (that of OTS) and to ensure parity between state and federally-chartered savings associations.

Current OTS regulations permit federal savings associations to assess a prepayment penalty (12 CFR 560.34). OTS regulations also allow a federal savings association to charge a late payment fee, subject to certain restrictions (12 CFR 560.33): the late charge may not be assessed within the first 15 days after an installment is due, the date the late charge will apply must be clearly disclosed, only one late charge may be assessed for a particular installment, a late charge is not considered interest, and late charges may not be deducted from other periodic payments but must be collected from the borrower as late charges.

When the OTS first began to examine the Parity Act two years ago in the context of predatory lending, industry commenters urged the agency to focus on enforcement and education rather than revisions to the Parity Act as a means to address predatory lending. At that time, the industry stressed the difficulty – if not impossibility – of trying to design a regulation limited to predatory loans without also affecting legitimate loan terms that help less credit-worthy borrowers access credit. And, as noted by the OTS, "financial institutions and their trade organizations generally supported the existing Parity Act rules as enhancing credit availability and enabling lenders to develop new mortgage options."³

If the changes to the Parity Act are adopted as proposed, only OTS regulations on adjustments to home loans (governing changes in interest rates, payment amounts and loan balances) and disclosures for variable rate transactions would still pre-empt state law under the Parity Act. In other words, state chartered creditors could elect to follow these OTS rules instead of state requirements. In all other instances, state law would apply.

The Proposal

Under the proposal, OTS regulations on prepayments and late charges would no longer pre-empt state law under the Parity Act. While state-chartered housing lenders would be subject to applicable state laws, federally chartered savings associations would continue to follow OTS regulations instead of state law.

The ICBA shares the OTS' concern with predatory lending. Unfortunately, expressing the concept in legislative or regulatory language and identifying appropriate changes to law or regulation has proved elusive. The ICBA urges the OTS to work with other federal regulators and state agencies to identify the bad actors and enforce existing laws against them. Recently, the Federal Trade Commission has undertaken enforcement actions against several predatory lenders, and this is a good beginning. Enforcing existing laws against the bad actors is preferable to blanket regulatory steps, such as elimination of

³ *Federal Register*, April 25, 2002, p. 20469.

the parity provisions, that may have unfortunate and unintended consequences that further disadvantage subprime borrowers. As noted by Federal Reserve Board Governor Edward Gramlich, "the best solution in many cases may simply be stricter enforcement of current laws."⁴

The OTS believes its rules on prepayment penalties and late charges do not have a great impact on the ability of a state-chartered housing lender to offer alternative mortgage products, which is the rationale underlying the Parity Act's pre-emption provisions. However, the ICBA believes there are important factors that the OTS should consider. For example, the ability to sell loans on the secondary market is important for many lenders, especially those that rely on those sales to maintain sufficient funding for new loans. The ability to impose a standard prepayment penalty may affect a lender's ability to sell loans on the secondary market, especially subprime loans. Since subprime lending is an important mechanism to reach those with tarnished credit, frequently low- and moderate-income borrowers, any decision that the OTS reaches should not diminish the ability of state lenders to sell loans on the secondary market. The competitive playing field should be kept as level as possible, particularly between state and federal lenders. Consistency across various regions also will help stimulate the availability of credit by facilitating sales on the secondary market. Moreover, the more uniform that prepayment penalties are, the easier it will be for consumers to understand them. Having OTS regulations set the standard by pre-empting disparate state requirements is therefore useful to facilitate access to credit.

A second factor that must be weighed in the equation is the important distinction between subprime lending and predatory lending. Subprime lending allows legitimate lenders to offer less creditworthy borrowers loans on terms that recognize the risks that these borrowers present, while at the same time allowing these borrowers the chance to improve their credit history. It also allows depository lenders to craft lending programs that help reach borrowers in all segments of the community, without undertaking undue risks because borrowers have less than perfect track records. One step that should be avoided is creating draconian restrictions on subprime lending activities that force legitimate lenders out of the subprime market, creating an even more fertile field for predators. Eliminating the Parity Act provisions as proposed and subjecting lenders to disparate state laws might have this kind of impact.

Depository institutions which are regularly examined for compliance with consumer laws and regulations, are rarely, if ever, likely to engage in predatory lending practices. Rather, the culprits are more likely lenders that are either unlicensed or unsupervised. Regulatory changes should be directed at those specific lenders and not at all state chartered lenders. State authorities need to take the appropriate steps to ensure that the pre-emption is not abused by state licensed institutions. However, this does not mean the pre-emption should be eliminated. At a minimum, the preemption should be maintained for the highly regulated state-chartered savings institutions even if it is dropped for other, less regulated, state licensed housing creditors.

⁴ Gramlich Testimony, House Banking Committee hearing, May 24, 2000.

Before undertaking regulatory changes, the ICBA also believes that efforts underway to promote financial literacy should be more extensively explored. An educated consumer is less likely to be susceptible to the kinds of abusive or deceptive activities that characterize predatory lending. Anecdotal evidence suggests that many predatory loans violate existing requirements. Moreover, if borrowers better understand the basics of finance, the opportunities for predators to take advantage of them will diminish.

Overall, the ICBA believes that increased education efforts and counseling programs for those that would benefit by them, coupled with expanded enforcement efforts by the FTC and the appropriate state authorities, would do more to combat predatory lending practices than the proposed changes. Furthermore, the potential that these changes could actually disadvantage certain subprime borrowers indicates that, in the balance, the potential costs to the changes outweigh the benefits. Therefore, the changes should not be implemented.

Thank you for the opportunity to comment. If you have any questions or need any additional information, please contact Robert Rowe, ICBA's regulatory counsel, at 202-659-8111 or robert.rowe@icba.org.

Sincerely,

A handwritten signature in cursive script that reads "A. Pierce Stone". The signature is written in black ink and is centered on the page.

A. Pierce Stone
Chairman