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June 24, 2002

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

Re: Docket No. 2002-17

Dear Sirs and Madams:

By way of introduction, this firm, Buchalter, Nemer, Fields & Younger, represents numerous state chartered and licensed mortgage lenders in the prime and subprime lending industries. At the request of our clients, we have drafted this comment letter to the Office of Thrift Supervision (the "OTS") in response to the OTS' proposed rule amending the requirements of its regulations (the "Amendments") that relate to "alternative mortgage transactions" or "AMTs."¹ Specifically, this comment letter addresses the OTS' request for public comment regarding the proposed modification of the OTS' regulations implementing the Alternative Mortgage Parity Act as set forth at Section 560.220 of the OTS' regulations.²

As an initial matter, we commend the OTS in its efforts to encourage fair and equitable mortgage lending throughout the United States by both state and federally chartered lenders. Our clients believe that continuing dialogue among representatives of federal and state governmental agencies, lenders and consumer representatives will facilitate the elimination of unfair lending practices and the expansion of the availability of mortgage credit.

However, we must point out that the proposed Amendments will neither reduce unfair lending practices nor expand credit availability. Moreover, the proposed OTS action raises very significant legal concerns—including the fundamental ability of the OTS to adopt the Amendments as proposed.

There are several legal issues that we wish to address regarding the proposed Amendments: (a) the Parity Act's limitations on the OTS' regulatory discretion; (b) the Parity Act's specific opt-out authority provided to states; (c) the conflict created by the proposed Amendments with past OTS interpretative positions regarding the Parity Act;

¹ 67 *Fed. Reg.* 20468 (April 25, 2002).

² 12 U.S.C. § 3800 *et seq.*; 12 C.F.R. § 500 *et seq.* (the "OTS Regulations").

and (d) the significant harm that the proposed Amendments will have on preemption theory in general.

Each area of legal concern will be addressed separately below.

1. The Parity Act

The Parity Act was enacted by Congress to enable state housing creditors (“Housing Creditors”) to make, purchase, and enforce AMTs.³ The Parity Act applies to loans that vary from the traditional fixed-rate, fixed term mortgage loans, and includes loans that have variable rates, balloon payments or call features, hence the term “alternative mortgage transaction.”

As stated therein, “[i]t is the purpose of [the Parity Act] to eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions.”⁴ Accordingly, Congress specifically gave Housing Creditors the authority to make, purchase, and enforce AMTs *to the same extent* as their federally chartered housing creditor counterparts.⁵ In conferring upon Housing Creditors the authority to engage in AMTs, Congress emphasized that the purpose of the Parity Act was to “prevent discrimination against State-chartered depository institutions,” and accomplished that goal by specifically preempting contrary state laws.⁶

In response to consumer groups, the OTS has proposed to delete from Section 560.220 of the OTS Regulations the current references to Sections 560.33 and 560.34 of the OTS Regulations—which relate to permissible prepayment penalties and late charges that may be included in home loans by federal savings associations. According to the OTS, the intended effect of this regulatory modification—a “reverse preemption,” if you will—would be to allow states once again to regulate Housing Creditors regarding the terms of prepayment and late charge provisions.⁷

In order to justify its position, the OTS argues that the structure of the Parity Act calls for a “bottom up” approach to regulation. The OTS takes the position that the purpose of Parity Act was to enable lenders to make AMTs, and that state laws were to be preempted

³ We acknowledge that six states have opted-out of the requirements of the Parity Act, and exclude from this discussion those jurisdictions.

⁴ 12 U.S.C. § 3801.

⁵ 12 U.S.C. 3803(a) (emphasis added).

⁶ 12 U.S.C. § 3803(a). While beyond the scope of this comment letter, we note that the OTS’ strained attempt to avoid the plain meaning of the terms “parity” and “discriminate” within the context of the Parity Act would probably not be viewed favorably by a court reviewing the validity of the OTS’ exercise of its regulatory authority.

⁷ Among other things, the proposed modification would impliedly overrule *Shinn v. Encore Mortgage Services, Inc.*, 96 F. Supp.2d 419 (D.N.J. 2000), holding that New Jersey’s prepayment penalty laws are preempted by the Parity Act.

to the extent that they prohibited AMTs. Further, the OTS claims that the Parity Act conferred upon the OTS authority to set forth regulations to carry out the Parity Act's purposes (*i.e.*, to facilitate AMTs). The OTS argues that it has the latitude to adopt regulations to facilitate the origination of AMTs—but that the OTS may discriminate against Housing Creditors if it chooses to do so. Thus, the OTS argues, if its implementing regulations do not absolutely prohibit AMTs, then limiting the types of AMTs that might be originated by a Housing Creditor is statutorily authorized by the Parity Act.

Assuming this “bottom up” perspective is correct, the OTS claims that only certain regulations are *essential* to enable AMTs to be originated by Housing Creditors. However, other regulations included as part of the OTS Regulations that are not “intrinsic to the ability to offer alternative mortgages” may be included or excluded in coverage under the Parity Act in the OTS' discretion. According to the OTS, because prepayment and late charge provisions are not “essential” to the ability of a Housing Creditor to originate an AMT, the OTS is authorized to delete those provisions from coverage under the Parity Act.

We note to the OTS that—contrary to its “bottom up” approach to the Parity Act—a plain reading of the Parity Act dictates a “top-down” approach, which leads to the inescapable conclusion that the proposed Amendments are contrary to the OTS' statutory authority under the Parity Act. Stated another way, the Amendments as proposed by the OTS violate the clear mandate set forth in the Parity Act that *the OTS cannot discriminate against Housing Creditors—which is a direct and specific limitation on the OTS' regulatory discretion.*

Contrary to the OTS' position, the Parity Act does not authorize federal housing creditors such as federal savings associations to engage in AMTs, nor does it allow the OTS to adopt regulations to authorize AMTs. Rather, as noted above, the literal language of the Parity Act indicates that the Parity Act was intended by Congress to “eliminate the discriminatory impact that those regulations 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 regulations issued by Federal agencies.” In other words, the Parity Act was intended to provide Housing Creditors with parity with their federal counterparts.

More specifically—and contrary to the OTS' position—the Parity Act does *not* provide the OTS the ability to adopt regulations that limit in any manner the type of AMTs that might be originated by a Housing Creditor *if the same AMTs could be originated by a federal savings association.* In other words, the Parity Act permits—but also limits—the OTS to identify those portions of the OTS Regulations that a Housing Creditor must comply with in order to make an AMT that might be originated by a federal savings association. To the extent that the OTS attempts to issue regulations that have the effect

of distinguishing (*i.e.*, discriminating) between an AMT that may be made by a federal association and by a Housing Creditor, the proposed action by the OTS is beyond the OTS' statutory authorization.⁸

In addition, we note that the Parity Act states that Housing Creditors can originate AMTs made in accordance with the *regulations* governing alternative mortgage transactions issued for federal associations.

In that regard, the OTS has adopted Section 560.2 of the OTS Regulations, which states that the OTS "occupies the entire field of lending regulation." Moreover, Section 560.2(b) specifies which state laws are specifically preempted. Included in the list of state laws that are preempted are late charges and prepayment penalties.⁹

If the Parity Act is to be given effect, then Housing Creditors must be allowed to be governed by the same regulations that govern the AMT lending by federal savings associations, including Section 560.2(b)(5) of the OTS Regulations. Accordingly, the OTS' proposed elimination of Sections 560.33 and 560.34 from the list of regulations identified in Section 560.220 of the OTS Regulations will not alter the fact that Section 560.2(b)(5) will continue to apply to Housing Creditors, with the result that state laws as to prepayment penalties and late charges will continue to be preempted as to AMTs originated by Housing Creditors. In other words, the structure of the Parity Act—as consistently applied by all of the federal banking agencies that have issued implementing regulations—results in the conclusion that if the OTS *deletes* a reference to a specific regulation that would be applicable to a federal association, a Housing Creditor could still originate AMTs on an equal basis with federal associations—but would be exempted from complying with any consumer protections that might otherwise apply to federal savings associations.¹⁰

⁸ This is not to say that the OTS is without regulatory discretion to limit the nature or type of AMTs that might be originated by Housing Creditors—provided that the OTS does not discriminate by employing the "top down" rule required by the Parity Act. This means, for example, that if the OTS wished to require that state mortgage lenders comply with state prepayment and late charge provisions, the OTS would be required to amend the OTS Regulations to also require that federal savings associations comply with state laws regarding these loan terms.

⁹ Section 560.2(b)(5) of the OTS Regulations.

¹⁰ As one of the participants involved in the drafting of the language that ultimately became the Parity Act, the undersigned points out that the structural limitations built into the Parity Act in regard to regulatory discretion was specifically intended to prevent what the OTS is currently attempting to achieve—namely a disparity between the types of AMTs that might be originated by a federal savings association and by a Housing Creditor.

2. Congress Has Accounted for State's Rights in Allowing States to Opt-out of the Parity Act

The OTS indicated in the information accompanying the proposed Amendment that the OTS believes that states be afforded a new opportunity to opt-out from the preemption afforded to Housing Creditors by the Parity Act. However, as the OTS is aware, all 50 states had three years following the enactment of the Parity Act to override or opt-out of the Parity Act's federal preemption. This evidences Congress' intent to occupy the field of AMTs for Housing Creditors and to allow Housing Creditors to engage in AMTs to the same extent as federal housing creditors.

We believe it is ill advised from a policy perspective for a federal agency to attempt to reverse by regulation a result that was specifically mandated by federal legislation. While we do not wish to comment on the wisdom of providing a new three-year opt-out period, we do wish to point out that the existence of the three-year opt-out provision in the Parity Act is dispositive of the preemptive effects of the Parity Act regarding prepayment and late charge provisions in those states that chose not to opt-out.

3. The OTS' Proposal Contradicts Its Long-Standing Interpretative Position

We also note that the OTS has previously supported the legal position that Housing Creditors are entitled to engage in AMTs to the same extent as federal savings associations. The OTS' current proposal to create a disparity between federal and state housing creditors is in contradiction to its prior policy interpretations.

For example, in an OTS opinion letter, dated April 30, 1996, the OTS stated that the Parity Act preempted a Wisconsin statute limiting prepayment penalties. The OTS opined that "if state housing creditors were required to follow the Wisconsin Statute when making variable-rate mortgage loans, they would be clearly disadvantaged vis-à-vis federal thrifts—the very result Congress intended to prevent."¹¹ Furthermore, in reaching its decision, the OTS looked to the purpose and Congressional intent behind the Parity Act and noted that the "Parity Act expressly states that Congress wished to 'prevent discrimination against State-chartered depository institutions and other nonfederally chartered housing creditors.'" Accordingly, the OTS has previously taken the position that the purpose of the Parity Act is to prevent discrimination between Housing Creditors and federal associations regarding identical AMTs; however, the proposed Amendments have an opposite result—namely, they discriminate against Housing Creditors.

¹¹ Emphasis added.

Similarly, in an OTS opinion letter, dated November 27, 1996, the OTS stated that the “express purpose of the Parity Act is to ensure that state-chartered lenders may originate mortgage loans ...to the same extent as federal lenders....If state lenders were not permitted to originate these loans, they would clearly be disadvantaged vis-à-vis federal thrifts, contrary to Congressional intent.” Again, the OTS argues that Housing Creditors must be permitted to engage in AMTs to the same extent as federal associations.

Applying the guidance relied upon—and issued by—the OTS in the past, the test to be applied for determining the applicability of the Parity Act to a particular loan is straightforward. First, is the particular loan in question an AMT as defined by the Parity Act? Second, may the loan be originated by a federal savings association pursuant to the OTS Regulations? If the answers to the foregoing questions are in the affirmative, a Housing Creditor may originate an AMT, subject to compliance with specific provisions of the OTS Regulations identified by the OTS as applying to AMTs and as set forth in Section 560.220 of the OTS Regulations.

4. The Proposed Rule Undermines Court Decisions Regarding Preemption and the Parity Act.

In a leading judicial case in the area, *Shinn v. Encore Mortgage Services, Inc.*, 96 F. Supp.2d 419 (D.N.J. 2000), the court stated that a “paramount purpose of the [Parity] Act is [to] create parity between state and federal lenders who engage in AMTs [alternative mortgage transactions].” The court held that New Jersey’s prepayment law was preempted by the Parity Act.

While beyond the scope of this comment letter, we wish to point out to the OTS that the law of unintended consequences may apply should it adopt the proposed Amendments. Specifically, the strained rationale employed by the OTS to justify the proposed Amendments may be used in unrelated litigation to undermine the applicability of the legal theory of federal preemption. We strongly urge the OTS to reconsider whether it is endorsing a legal theory that might be relied upon to argue that state law should be preempted only when “intrinsicly” necessary to the effectuation of a federal policy or goal. We believe that an evaluation of the implications of the OTS’ rationale employed to justify the Amendments will result in the OTS electing to abandon its position because of the threat the theory presents to preemption in general.

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We appreciate the opportunity to comment to the OTS regarding the proposed Amendments. Based upon the analysis set forth herein, we believe the OTS should conclude that it lacks the statutory authority to adopt the Amendments as drafted.

Very truly yours,

Buchalter, Nemer, Fields & Younger

By: Joseph T. Lynyak, III

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