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CONSUMER MORTGAGE COALITION

June 13, 2002

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

RE: Docket No. 2002-17 (Alternative Mortgage Transaction Parity Act; Preemption)

Ladies and Gentlemen:

The Consumer Mortgage Coalition ("CMC"), a trade association of national residential mortgage lenders, servicers, and service providers, appreciates the opportunity to comment on the proposed amendments (the "Proposed Rule") of the Office of Thrift Supervision (the "OTS") to its regulations implementing the Alternative Mortgage Transactions Parity Act (the "Parity Act" or the "Act"), 12 U.S.C. §§ 3801 *et. seq.* *See* 67 Fed. Reg. 20468 (Apr. 25, 2002).

The OTS' Parity Act regulation, 12 C.F.R. § 560.220, lists those provisions of the OTS' general lending regulations that apply to state-licensed housing creditors ("Housing Creditors") making alternative mortgage loans under their Parity Act authority. Currently, 12 C.F.R. § 560.220 includes the OTS rules on prepayment penalties and late fees, 12 C.F.R. §§ 560.33 and 560.34, among the rules that apply to Housing Creditors. As a result, Housing Creditors may make Parity Act loans consistent with those regulations and without consideration of most state laws on prepayment penalties or late fees.[1] The Proposed Rule would amend 12 C.F.R. § 560.220 to eliminate provisions governing late fees and prepayment penalties from the list of provisions applying to Housing Creditors making alternative mortgage loans under the Parity Act.[2] As a result, Housing Creditors would be subject to all state laws governing these aspects of a mortgage transaction, even when making alternative mortgage loans.

We commend the OTS for its commitment to protecting consumers from abusive mortgage lending practices. No one wants to end abusive lending practices more than we do. The abusive practices of a few have harmed the reputation of the entire mortgage lending industry – an industry overwhelmingly comprised of honest lenders committed to helping consumers obtain affordable housing credit according to each consumer's unique needs and circumstances. We

1 We say "most" rather than "all" because six states have exercised their right under 12 U.S.C. § 3804(a) to opt out of the Parity Act: Arizona (with regard to small loans only), Maine, Massachusetts, New York, South Carolina, and Wisconsin. *See* CCH Consumer Credit Guide ¶510; N.Y. Banking Code § 6-8.

2 The OTS also proposes a number of other amendments. The CMC supports these amendments and will focus our comments on the amendments to the Parity Act regulations.

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oppose abusive lending practices, and we fully support effective initiatives to identify and stop unscrupulous lenders and brokers. We are concerned, however, that the Proposed Rule will not curb abusive lending. Instead, the Proposed Rule could exacerbate the problem by giving consumers fewer housing credit options at higher prices, while harming mortgage lending throughout the nation.

For these and other reasons, discussed in detail below, we urge the OTS not to make piecemeal changes to its Parity Act regulations that will ultimately have none of their desired effect. Instead, we reaffirm our recommendation, made in our letter dated July 5, 2000 (the "ANPR Letter"), responding to the OTS' Advanced Notice of Proposed Rulemaking, 65 Fed. Reg. 17811 (the "ANPR"), that the OTS actively advocate comprehensive federal mortgage reform. Comprehensive mortgage reform can guarantee that all borrowers receive meaningful, easy-to-understand information about their loans. The right reforms can also stimulate healthy competition for all loan products, ensuring that consumers have adequate choices among financial services. In the absence of comprehensive reform, we think that the only course open to the OTS, consistent with the Parity Act, is to formulate its own abusive lending regulations, applicable to federal thrifts and Housing Creditors alike.

<u>Effects of the Proposed Rule</u>

The Proposed Rule would eliminate provisions governing prepayment penalties and late fees from the OTS regulations that apply to Housing Creditors who make alternative mortgage loans. As a result, federal preemption will no longer protect Housing Creditors from state laws and regulations governing prepayment penalties and late fees. In this way, the Proposed Rule will give federal housing creditors a significant competitive advantage over Housing Creditors.

Prepayment penalties are a typical feature of alternative mortgage loans. The protection of prepayment penalties makes it possible for many lenders to offer borrowers lower interest rates. If prohibited from charging prepayment penalties, Housing Creditors will not be able to charge the same low interest rates that federal thrifts can charge. This means that in a number of states, Housing Creditors will no longer be able to offer many alternative mortgage loan products at rates competitive with those offered by federal thrifts.

Similarly, in states that prohibit the imposition of late fees or restrict their use more severely than the federal rules, the Proposed Rule will deny Housing Creditors adequate tools to encourage timely payment and recover late payment costs.[3] Yet these tools will be available to federal thrifts. As a result, federal thrifts will be able to service their portfolios at lower cost, reaping efficiencies that they can take as greater profits or pass on to consumers in the form of lower costs. Housing Creditors will be unable to make these profits or match these costs.

To comply with newly applicable state laws, Housing Creditors may have to eliminate numerous mortgage products. To remain financially competitive, many Housing Creditors will have to increase the prices of their remaining products. Many more will be forced to exit the alternative mortgage lending market altogether.

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[3] The OTS notes that the ability to assess late fees helps housing creditors "encourage the timely payment of loans and ... recover costs associated with late payments." 67 Fed. Reg. at 20470.

In turn, consumers will suffer. They will have fewer mortgage loan options. As competition diminishes, they will ultimately be forced to pay higher prices for the products that remain available.

These effects directly contradict the purpose of the Parity Act and do nothing to combat abusive lending. Scaling back preemption privileges under the Parity Act on an unequal basis would reintroduce the competitive disparity, which the Act was intended to abolish, between federally-chartered lenders and Housing Creditors. By making alternative mortgage lending uneconomical for nonfederally chartered housing creditors, the Proposed Rule would burden the entire lending industry with conflicting and inconsistent compliance obligations; limit choices of consumers; and raise the cost of credit as competition dwindles. And yet, the Proposed Rule would not strike at the root factors that permit lending abuses: inadequate understanding of loan terms and conditions; inadequate ability to choose among competing loan products; and inadequate enforcement of fraud statutes already on the books.

<u>Incompatibility With Parity Act, Legislative Intent and Regulatory Interpretations</u>

"Parity" means parity.

We respectfully but strongly disagree with the OTS' interpretation of the Parity Act and its underlying purpose. The Parity Act empowers non-federally chartered housing creditors to make alternative mortgage loans in the same way that federally chartered entities do. This means that state and federal housing creditors are subject to the *same basic restrictions, prohibitions*, and conditions in making alternative mortgage loans. In this way, the Parity Act ensures that federal housing creditors do not have a competitive advantage over Housing Creditors because they are subject to different regulatory restraints, and vice versa. In short, under the Parity Act, "parity" means parity.[4]

[4] Webster's Dictionary defines "parity" as "1. Equality, as in value, position, or amount. 2. Functional equivalence, as in the development of strategic arms. 3. The equivalent in value of a sum of money expressed in terms of a different currency at a fixed, official rate of exchange. 4. Equality of prices of goods or securities in two different markets. 5. A level for farm-product prices maintained by governmental support and intended to give farmers the same purchasing power they had during a chosen base period. . . ." See Webster's II: New College Dictionary 799 (1999). Webster's standard definitions are relevant here for three reasons. First, unless otherwise defined in the Act, we can reasonably assume that Congress intended to employ the term "parity" according to its commonly understood definition – "equality" or "functional equivalence." *See, e.g., Sutton v. United Airlines*, 527 U.S. 471, 491 (1999) (relying on Webster's Third New International Dictionary (1976) to determine the meaning of the term "substantially" in the Americans with Disabilities Act of 1990, 42 U.S.C. § 12101 *et seq.*, § 12102(2)(A)). Second, Webster's reference to strategic arms is apt because Congress passed the Parity Act at the height of the strategic arms race during the Cold War. At the time, "parity" was a term used regularly in that public policy arena to indicate an even balance between the Soviet Union and the United States in strategic arms capability. The key strategy toward creating "functional equivalence" was ensuring that both countries were subject to the same rules. Given this context, a logical conclusion is that, in passing the Parity Act, Congress understood "parity" to signify a meaningful competitive balance between state and federal housing creditors, achieved through equal application of the same basic rules. Finally, Webster's definitions highlight that "parity" is used frequently in economics parlance to indicate effective marketplace equality – again, achieved by applying rules in a particular way – which we contend is precisely what Congress intended the Parity Act would bring about between state and federal housing creditors.

The legislative history of the Act reinforces this plain language interpretation. Congress briefly commented 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.

S. Conf. R. 97-641 at 94 (reprinted in 1982 U.S.C.C.A.N. 3128, 3137). Contrary to applying rules equally, as the Parity Act requires, the Proposed Rule would apply different rules to federal housing creditors than Housing Creditors.

Congress intended the Parity Act to apply to all regulations relevant to alternative mortgage lending.

As the OTS notes, the primary purpose of the Parity Act is

> 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 the regulations issued by the Federal agencies.

12 U.S.C. § 3801(b) (emphasis added). Thus, the Act's purpose is two-fold: to "eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors" and "provide them with parity with federally chartered institutions[.]" *Id.*

The Proposed Rule would leave non-chartered Housing Creditors with technical, legal permission to make alternative mortgages. But it would significantly reduce their ability to actually make alternative mortgage loans, because they will be placed in a worse competitive position. Each alternative mortgage involves a wide array of terms and conditions. Thus, *nominal parity – mere legal permission to make alternative mortgage loans – cannot end* discrimination against Housing Creditors wishing to make alternative mortgage loans. Truncating application of the Parity Act so that Housing Creditors have nothing but an empty shell of nominal parity with federal thrifts makes the Act meaningless and disregards Congress's concerns in passing it.

In passing the Parity Act, Congress recognized that the unequal treatment of Housing Creditors under the prevailing legal framework seriously disadvantaged Housing Creditors. This discriminatory legal framework harmed consumers as well, by giving them fewer options for affordable credit.[5] Congress passed the Act to level the regulatory playing field so that Housing Creditors could actually make alternative mortgage loans, which means that they would be on a competitive par with their federal counterparts. In this way, American consumers could have more tangible options for affordable housing credit.

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[5] Specifically, Congress found that most Housing Creditors were denied a critical tool for "provi[ding] an adequate supply" of housing credit – the ability to make alternative mortgage loans. See 12 U.S.C. § 3801(a).

The Proposed Rule, however, narrowly interprets the language of the Act that permits Housing Creditors to make alternative mortgage loans, namely, the section stating that the Act's purpose is "to eliminate the discriminatory impact that [restrictive state] regulations have upon nonfederally chartered housing creditors." 12 U.S.C. § 3801(b). The OTS' apparent view is that the only regulations that expressly forbid or expressly applies exclusively to alternative mortgage transactions should be preempted.

Thus, in the OTS' view, the Proposed Rule would not have a discriminatory impact on Housing Creditors, because states apply restrictions on prepayment penalties and late fees to all types of loans, not just alternative mortgage loans. Because these laws are not exclusively applicable to alternative mortgage transactions, the OTS argues, these state laws "are not directed at restricting alternative mortgage transactions." 67 Fed. Reg. at 20470.[6]

This analysis is flawed for two reasons. First, the Parity Act is concerned with inequality in how regulations apply to various types of <u>housing creditors</u>, not various types of <u>loans</u>. Whether the state laws to which Housing Creditors would be subject apply generally or only to alternative mortgages is irrelevant. Discriminatory impact would result because Housing Creditors would be subject to these rules and federal thrifts would not.

Second, whether states have discriminatory <u>intent</u> in passing mortgage-lending regulations is irrelevant to the Parity Act's express concern with discriminatory <u>impact</u>. If applied only to Housing Creditors, state laws and regulations will give federal housing creditors an unfair competitive advantage over Housing Creditors. The discriminatory effect of laws and regulations applied unequally occurs regardless of the reasons states enacted them.

In our view, the Act's express purpose, stated above, makes it clear that Congress intended the Parity Act to apply to more regulations than those authorizing, or expressly pertaining to, alternative mortgage transactions. Again, the purpose of the Act is not only to "eliminate discriminatory impact" with respect to specific regulations ("those regulations"), but also to "provide parity" with respect to "the regulations issued by the Federal agencies." 12 U.S.C. § 3801(b).

Congress's broader reference to "regulations" indicates that Congress understood that true parity requires applying all regulations relevant to alternative mortgage transactions to state and federal institutions on an equal basis.[7]

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[6] Specifically, the OTS asserts that "[s]tates that restrict prepayment penalties and late fees generally apply those restrictions to all real estate loans, not just to alternative mortgage transactions. The states' laws in these areas are not directed at restricting alternative mortgage transactions but in regulating mortgage transactions in general." 67 Fed. Reg. at 20470.

[7] The OTS notes that Congress did not mention fees or penalties in the Parity Act, nor direct the agencies to consider their impact. *See* 67 Fed. Reg. at 20470 n. 19. On this basis, the OTS concludes that Congress intended to constrain federal agencies from applying regulations that did not expressly authorize or relate to alternative mortgage lending. We believe that a more plausible interpretation of Congress's omission of specific references to fees or penalties is that Congress recognized, and intended to defer to, the agencies' expertise in determining which regulations should apply to Housing Creditors to accomplish parity with federal housing creditors.

The NCUA and OCC regulations provide parity between state and federal housing creditors.

The OTS suggests that the Proposed Rule is consistent with the Parity Act regulations of the National Credit Union Administration (the "NCUA") and the Office of the Comptroller of the Currency (the "OCC"). In fact, however, the NCUA and OCC Parity Act regulations underscore the basic point about what parity requires – that state and federal housing creditors be subject to the same rules. As the OTS points out, the NCUA applies all its regulations to Housing Creditors, and does not permit any credit unions, federal or state, to impose prepayment penalties for any loan. *See* 12 C.F.R. § 701.21(a). In other words, under the NCUA regulations, federal and state credit unions are subject to precisely the same rules. The prepayment penalty prohibition, along with all other NCUA rules, applies equally to federal and state credit unions. Thus, under the NCUA regulations, federal and state credit unions have parity in making alternative mortgage loans.

The OTS also notes that the OCC's Parity Act regulations include only those specifically addressing adjustable rate mortgages,[8] which permit prepayment penalties but do not address late fees. *See* 12 C.F.R. § 34.24. Again, however, the OCC regulations, taken as a whole, effectively grant parity to state and federally chartered banks, because the same basic rules apply to both. Although the OCC does not mention late fees in its adjustable rate mortgage regulations, the OCC regulations subject both state and federal banks to state limitations on late fees.

Specifically, the OCC regulations include "late fees" in the definition of "interest," as used in Section 30 of the National Bank Act of 1864, Rev. Stat. § 5197, as amended, 12 U.S.C. § 85 ("Section 85"). *See* 12 C.F.R. § 7.4001(a). Section 85 provides that "[a]ny association may . . . charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located." 12 U.S.C. § 85 (emphasis added). Under the OCC regulations, federal banks must abide by state law limitations on interest and its various components, including late fees, in the states in which they reside. *See Smiley v. Citibank (South Dakota) N.A.*, 135 L.Ed.2d 25 (1996); OCC Interpretive Letter No. 803 (Oct. 1997); OCC Interpretive Letter No. 607 (Feb. 1995).[9]

Again, under OCC regulations, state and federal banks have parity in making alternative mortgage loans.

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[8] The OCC regulations define an "adjustable rate mortgage" as "an extension of credit made to finance or refinance the purchase of, and secured by a lien on, a one-to-four family dwelling, including a condominium unit, cooperative housing unit, or residential manufactured home, where the lender, pursuant to an agreement with the borrower, may adjust the rate of interest from time to time. An ARM loan does not include fixed-rate extensions of credit that are payable at the end of a term that, when added to any terms for which the bank has promised to renew the loan, is shorter than the term of the amortization schedule." 12 C.F.R. § 34.20

[9] In addition, federal banks are subject to state late fee rules in complying with state usury limitations. The OCC regulations provide that "late fees are not treated as interest for the purposes of evaluating [federal banks'] compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations." 12 C.F.R. § 7.4001(c).

Incompatibility With Mandate to Make Housing Credit More Available

The Parity Act was intended to strengthen the financial stability of home mortgage lending institutions and ensure the availability of home mortgage loans.

The Parity Act was passed in 1982 as part of the Garn-St. Germain Depository Institutions Act, Pub.L. 97-320, 96 Stat. 1469 (1982). This comprehensive legislation expanded the powers of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation and the NCUA to assist distressed institutions; broadened the lending and investment powers of federal thrifts; and, among other things, reformed many laws and regulations affecting commercial banks. *See* S. R. No. 97-536 at 3 (reprinted in 1982 U.S.C.C.A.N. 3054, 3056-57). Congress's express purpose in enacting this comprehensive legislation, which included the Parity Act, was

> to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans.

S. Conf. R. 97-641 at 85 (reprinted in 1982 U.S.C.C.A.N. 3128, 3128) (emphasis added). For this reason, any federal regulation under the Parity Act that undermines "the financial stability of home mortgage lending institutions" or curtails "the availability of home mortgage loans" contravenes Congress's clear intent in enacting the Parity Act.

As discussed throughout this letter, by placing Housing Creditors at a distinct competitive disadvantage vis-à-vis federal thrifts, the Proposed Rule would both undermine "the financial stability of home mortgage lending institutions" and curtail "the availability of home mortgage loans." Thus, by finalizing this Proposed Rule, the OTS would violate its mandate under the Parity Act.

The thrift industry was created to provide Americans with affordable housing credit.

In passing the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub.L. 101-73, 103 Stat. 183 (1989), which established the OTS, Congress recounted the entire history of the thrift system and strongly reaffirmed the purpose of the nationwide system of thrifts – to make affordable housing credit more available to Americans:

> Promoting the availability of affordable housing has been a primary goal of the Federal government for many years. In an effort to further that goal, the Congress and many state legislatures created the specialized thrift industry to provide people with mortgage credit . . . . [T]he thrift industry [is] an important vehicle for promoting our nation's housing goals through the provision of affordable mortgage credit. The [thrift] industry, and its extensive Government-backed support mechanisms, was enacted to provide Americans with an affordable source of mortgage credit . . . . The thrift industry was created to provide the American people with affordable mortgage credit.

H.R. 101-54(I) at 294, 309 (reprinted in 1989 U.S.C.C.A.N. 90, 105). Clearly, the purpose for having the thrift industry, supervised by the OTS, is to make affordable mortgage credit more available nationwide. Hindering healthy competition in the mortgage market, as the Proposed Rule would do, makes mortgage credit less affordable and less available. By finalizing a Proposed Rule that would give consumers fewer mortgage options at higher prices, the OTS would act in opposition its primary purpose.

Need for Parity Act

The Parity Act and the OTS regulations implementing the Parity Act have curbed predatory practices.

Lending abuses have occurred in spite of the Parity Act, not because of it. Lower prices and enhanced competition have consistently prevented lenders from offering uneconomic loans with unfair terms and conditions. The Parity Act dramatically opened the lending market in the 26 states that in 1981 prohibited or severely restricted such lenders from making such loans. *See* 65 Fed. Reg. at 17813. The increased competition which resulted directly benefited borrowers: it lowered the cost of credit in general and empowered lenders to create new products more closely tailored to the needs of various subgroups of borrowers.

Again, our experience has shown that a healthy, competitive mortgage market allows forward-looking lenders to drive out predatory lenders by offering consumers more economical loan packages and educational, user-friendly services. By establishing nationwide alternative mortgage lending standards, the OTS' rules have reduced the cost to lenders of complying with duplicative state regulations. Greater uniformity of terms has also made securitizing alternative mortgage loans easier. These developments have lowered the cost of credit to consumers across the nation. Alternative mortgage loan products have proven over time to be significant money savers for consumers. Forcing consumers to turn to fixed-rate products subjects them to higher costs over the long term.

The national standards mandated by the Parity Act are especially critical in today's alternative mortgage lending market

The OTS questions whether the Parity Act is necessary today because most states now permit alternative mortgage lending. *See* 67 Fed. Reg. at 20470. Far from being less important, however, parity in the application of a wide array of regulations that affect alternative mortgage lending is more important today than ever before. The mortgage lending market has evolved significantly since the Home Loan Bank Board promulgated its Parity Act regulations in 1983. Alternative mortgage lending has become more complex. More terms and options, including prepayment penalties and late fees, can determine the economic viability of each alternative mortgage loan. Although most states permit alternative mortgage lending, more and more have imposed an intricate maze of regulations that effectively prohibit alternative mortgage lending.

Thus, a narrow interpretation of the Parity Act overlooks the practical requirements for competitive alternative mortgage lending today. Given the current economics of alternative mortgage lending, mere permission to make alternative mortgage loans results only in nominal, not actual, parity.

As the preamble to the Proposed Rule notes, in 1996, the OTS acknowledged the realities of modern mortgage lending by expanding the provisions applicable to Housing Creditors under the Parity Act. *See* 61 Fed. Reg. 50951 (Sept. 30, 1996). These changes were entirely consistent with Congress's clear intent to facilitate competitive parity by creating a level regulatory playing field. By contrast, the Proposed Rule directly undercuts parity by applying regulations affecting alternative mortgage transactions unequally to state and federal housing creditors.

<u>Lack of Evidence of Abuse of Parity Act</u>

We are deeply troubled that the OTS appears to have proposed this Proposed Rule largely in response to anecdotal information and unsubstantiated allegations.[10] The OTS offers no evidence indicating that prepayment penalties and late fees are especially vulnerable to abuse. By its own admission,

> OTS does not collect information on housing creditors that take advantage of the Parity Act. . . . While commenters offered anecdotal information, OTS received <u>no comprehensive data</u> in response to the [ANPR].

See 67 Fed. Reg. at 20469, n. 15 (emphasis added). Moreover, the OTS has not explained how eliminating the application of these provisions to Housing Creditors will curb abusive lending practices, or how prepayment penalties and late fees are abusive in the hands of Housing Creditors but not federal savings associations. Thus, we fail to understand how the Proposed Rule will protect consumers. We do know for certain, however, that the Proposed Rule will take away from consumers numerous credit options, arrest innovations in new loan products that better meet consumer needs, and destabilize Housing Creditors nationwide.

<u>Alternatives for Effective Reform</u>

> ***If the OTS chooses a piecemeal approach, the OTS should issue regulations directly related to the problem areas identified and apply them equally to state and federal housing creditors.***

As discussed above, amending the OTS' Parity Act regulations is the wrong approach for curbing abusive lending practices, because the Parity Act's purpose is straightforward and limited. If, however, the OTS concludes – after careful examination of comprehensive, verifiable data – that the rules governing prepayment penalties and late fees contribute to abusive lending, then the OTS should strengthen those provisions and <u>continue applying them on an equal basis to state and federal housing creditors</u>.

The OTS also suggests that lack of oversight of non-chartered Housing Creditors may contribute to abusive lending practices. *See* 67 Fed. Reg. at 20470-71. We understand and appreciate the OTS' concern that non-chartered Housing Creditors may be inadequately scrutinized. If lack of oversight is in fact a problem, however, amending Parity Act regulations is an ineffective

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[10] The preamble to the Proposed Rule notes that unnamed states and consumer groups argue that applying late fee and prepayment penalty provisions to Housing Creditors "allow[s] non-depository institutions to piggy back on federal preemption and facilitate[s] predatory practices." 67 Fed. Reg. at 20469.

solution. Indeed, inadequate scrutiny of non-chartered Housing Creditors is irrelevant to whether the OTS' prepayment penalty and late fee provisions should apply equally to state and federal housing creditors under the Parity Act.

The best way to address a perceived weakness in oversight is directly, by proposing and supporting initiatives to strengthen oversight. The OTS can support and undertake initiatives on the federal level to (1) design comprehensive regulations prohibiting predatory lending or requiring additional disclosures that apply equally to all state and federal housing creditors; and (2) enforce existing consumer protection laws governing mortgage loan terms and disclosures, such as the Truth In Lending Act.

In addition, the OTS can advise and assist the states in their own oversight initiatives. The Parity Act expressly applies only to housing creditors properly licensed under state law. *See* 12 U.S.C. § 3802(2)(D). States are fully authorized to examine licensed Housing Creditors, require additional disclosures, institute a Housing Creditor registry, and take other measures to bolster oversight of housing creditors.

Because states have these powers, giving states another opportunity to opt out of the Parity Act, as the OTS recommends, is unnecessary – but would certainly, by further reducing uniformity, increase costs to consumers and lenders alike. Another opt out opportunity would upset long-settled expectations about which laws and regulations apply in which states, subjecting the entire mortgage lending industry to a confusing compliance quagmire. The uncertainty that this would introduce into the primary and secondary mortgage markets would likely have a significant, long-term negative impact on the nation's economy as a whole. In addition, giving states another opportunity to opt out of the Parity Act would set a destructive precedent, suggesting that it might be appropriate for states to opt out of other critical statutes, such as the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 161 (1980).[11]

The best approach is to advance comprehensive, nationwide mortgage reform.

The CMC firmly believes that the best approach to curbing abusive lending practices is comprehensive, nationwide mortgage reform. Comprehensive mortgage reform can (1) guarantee that all borrowers receive adequate and appropriate information about their loans, and (2) stimulate head-to-head competition for all loan products, ensuring that all categories of consumer have adequate choice of financial services. Mortgage reform on this scale requires the enthusiastic support of the federal banking agencies that will enforce the new regulatory scheme.

The support of the OTS is especially critical because the OTS has the most experience in preemptive nationwide regulatory issues and the greatest familiarity with residential mortgage lending.

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[11] The OTS also recommends that "Housing Creditors lending under the authority of the Parity Act be required to identify themselves to the states." 67 Fed. Reg. at 20471. This recommendation is also unnecessary because, as noted earlier, the Parity Act already limits its application to housing creditors licensed under state law. *See* 12 U.S.C. § 3802(2)(D). Again, states have authority to require additional disclosures, to establish a registration system for housing creditors and the loans they make, or take other measures to facilitate better oversight of Housing Creditors.

To attack predatory lending, measures to encourage a vibrant, competitive market for alternative mortgage loans should be coupled with a number of other nationwide efforts. As we discussed in the ANPR Letter, the CMC has consistently advocated a package of reforms, whose principal features are:

- *Mortgage Reform*. First, we need mortgage reform to simplify the mortgage shopping process and to encourage more borrowers, particularly those with blemished credit, to comparison shop for loans. This must start with reform of the RESPA regulations to allow a guaranteed sum of closing costs to be disclosed upfront to loan applicants, coupled with relief from RESPA's prohibitions that currently disallow the negotiation of volume discounts and other arrangements that could lower prices to consumers.

- *Public Awareness and Education*. Second, we need to institute a widespread public awareness and education campaign, which could include government-sanctioned tools to help consumers understand the loan process and to compare loans.

- *Counseling*. Third, we need to make financial counseling widely available to potential borrowers to help them make wise loan decisions.

- *National Licensing Registry*. Fourth, we should make the licensing violations of mortgage brokers and lenders available to the public so that borrowers can be forewarned when dealing with these entities.

- *Competitive Underwriting Systems*. Fifth, we need competitive underwriting systems that will provide the greatest opportunities for borrowers with some blemished credit to obtain the best loan.

- *Recovery of Home Equity in Foreclosure*. Sixth, we need to adopt a uniform rule that borrowers who have equity in their homes, but are facing foreclosure, be given a period to conduct a pre-foreclosure sale at market terms to enable them to keep the equity they have built up over the years.

- *Uniform National Rules*. Finally, to the extent federal legislation is pursued, we need uniform rules for the whole country that reflects the national nature of the mortgage finance business.

Each of these prescriptions is discussed in more detail in Exhibit A attached to this letter.

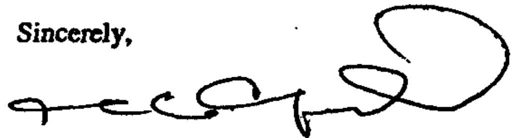
Conclusion

The Parity Act has been a major legislative success for the past two decades. As Congress originally intended, the Act has strengthened the financial stability of housing creditors and made affordable credit available to more consumers in every state. The Parity Act has enabled Housing Creditors to tailor loan products to meet individual consumer's specific needs. The Act has also given housing creditors the flexibility to develop new products, helping them adjust as needed to a rapidly evolving mortgage lending market.

Given these successes, we think that the OTS should not weaken the Parity Act by finalizing the Proposed Rule. If the OTS is serious about dealing with the problem of abusive lending, the OTS should do so with direct, sharply focused initiatives. Though well intentioned, the Proposed Rule would unfortunately burden entire classes of mortgage lenders, whom Congress expressly intended to free from discriminatory state regulation.

For all these reason, we respectfully request that the OTS withdraw the Proposed Rule.

Sincerely,



Anne C. Canfield
Executive Director

Attachment

EXHIBIT A

Reform Package to Attack Predatory Lending

Regulatory Relief: RESPA Reform

RESPA reform is necessary to allow market competition to bring maximum benefits to consumers in the form of lower settlement costs. This reform has four objectives: (i) to streamline and simplify the disclosures provided to borrowers so that they will have better and more certain information with which to make wise credit choices; (ii) to lower settlement costs by removing the regulatory barriers that insulate these costs from the effects of market competition; (iii) to reduce abusive lending practices, and (iv) to ease the burden of compliance by adding much-needed certainty into RESPA's and other related regulatory requirements, which should reduce the continual onslaught of class action litigation that is spawned by ambiguous rules.

The CMC has been working to accomplish these objectives since 1996 when, working with other mortgage trade associations, we developed a series of proposals to bring to Capitol Hill for consideration. At that time, members of Congress directed us to work with a broad group of consumer advocates and representatives of other banking, lending, title, real estate and other settlement services industries to reach consensus on broad-based mortgage reform, including substantive consumer protections. This resulted in the formation of the Mortgage Reform Working Group ("MRWG"), which, despite approximately two years' continuous meetings and negotiations, was unable to reach consensus among all the varying interests. Although the MRWG process yielded greater understanding of the concerns of divergent interest groups, at the end of the day it remains clear that the ultimate leadership for meaningful mortgage reform must come, not from the industry or the consumer advocacy groups, but from our government.

Much time has passed since the MRWG process ended, with no regulatory changes. That means that mortgage loans today continue to be governed by a disclosure scheme put in place over 25 years ago, at a time very different from our own.

The Value of Guaranteeing Settlement Costs

Our recommended reforms include the disclosure of a guaranteed, bundled closing cost amount. Contrary to the view, expressed by some consumer advocates, that a guaranty of settlement costs would provide little of value to the consumer, unless it also included a binding guaranty of the interest rate on the loan, we believe the guaranty of settlement costs addresses consumers' core complaint with the mortgage origination process – being "surprised" at closing by high costs and fees that either greatly exceed the cost or fee estimated on the good faith estimate or were not previously disclosed at all. Unexpected, high closing fees often leave borrowers in a no-win position at the closing table. Most borrowers will not walk away from the closing because they are too far along to start the process over. Some need the loan to consummate their purchase of a new home. Others may need the money to cover other expenses, like home repairs or college costs, which cannot be delayed. Whatever the reason, because of the pressures to close the transaction and get the loan, they often have no real choice but to pay the higher fees.

A guaranty of settlement costs will end this problem. Borrowers will know for certain early in the process what fees they will pay at closing. Most importantly, they will also be able to shop for loans based on these costs. Although we have recommended that the guaranteed closing costs would not be required to be disclosed until the application is taken (or within three days thereafter), lenders and brokers offering guaranteed closing cost packages will certainly promote these guaranteed costs during inquiries from potential borrowers. Any discrepancy between such a promotion and the immediately following application disclosure will be readily apparent for borrowers to question and possibly subject to charges of unfair and deceptive practices.

In addition, we need an exemption from RESPA's prohibitions for this guaranty to become a reality. With such an exemption, lenders will be able to use their purchasing power to compete these costs down (by negotiating and passing on volume discounts), helping to remove one of the major impediments - high closing costs - faced by first-time homebuyers seeking to close their first mortgage loan. Without it, lenders will have no incentive to incur the risk of truly guaranteeing all applicants' closing costs upfront. Moreover and more importantly, lenders will not be able to freely negotiate with vendors for lower costs. This guaranty and exemption is a very significant benefit to consumers and a vast improvement over the current disclosure process.

Finally, this reform proposal provides simplification. Consumers report being overwhelmed by the complexity of the home lending transaction. This change creates simplicity – allowing consumers to better focus on what is important. For these reasons it is simply not true to say that this guaranty is of little value to the consumer without a guaranty of the interest rate.

Comprehensive Public Awareness and Education Campaign

Federal policymakers should implement an ongoing, nationwide public service campaign to advise consumers, particularly the more vulnerable, of the basics of obtaining appropriate loans. Public service announcements could be made on radio and television, and articles and notices could be run in local newspapers and selected publications. Given that people's homes are at stake, these messages should be every bit as pervasive as the anti-smoking public interest announcements that have frequently appeared in the media in the last several years. This campaign should highlight the importance of obtaining the advice of an independent third party before signing any loan agreements.

Counseling

Once alerted, consumers will need to be able to avail themselves of counseling services from unbiased sources. Those sources can always include family and friends and industry participants. In addition, however, a nationwide network should be put in place to ensure that all consumers can easily access advice and counseling to help them determine the loan product that best fits their financial needs. A public awareness infrastructure could be built out that would include 1-800 numbers with independent counselors, using sophisticated computer software, to help consumers talk through the loan product they are considering. In addition, programs could be developed with community organizations and other organizations serving senior citizens to provide on-site counseling assistance at local senior and community centers and churches.

HUD's 800 number for counseling could also be listed on required mortgage disclosures as an initial step to increase awareness of available counseling.

The *Joint Report on RESPA and Truth in Lending Act* issued in 1998 by the U.S. Department of Housing and Urban Development ("HUD") and the Board of Governors of the Federal Reserve System (the "Board") recommended that the government develop "smart" computer programs to help consumers determine the loan product that best meets their individual needs. Mortgage calculators or "smart" computer programs are now available online. Since these computer programs were already developed by the private sector and are widely available, a process where the Board reviews and certifies those programs that it determines are effective in enabling consumers to comparison shop among loans would lend credibility to, and increase the use of, these programs.

Nationwide Licensing Registry

Consumers need to be able to evaluate the competency and integrity of the mortgage originators with whom they are dealing. For this reason, a nationwide licensing registry should be established on which state regulators could detail consumer complaints, licensing suspensions and revocations that would be accessible to consumers. The bonding requirements for mortgage brokers should also be increased so that claims against predatory mortgage brokers are more viable.

Competitive Automated Underwriting Systems

Enhanced competition serves borrowers, both in terms of lower costs and greater choices. While we have put forth a proposal to increase competition for a loan's costs, we also need greater competition in the underwriting systems that are used to underwrite the vast majority of mortgage loans in this country, which will lead to greater choices. The problem is that two automated underwriting systems ("AUS") – Freddie Mac's Loan Prospector and Fannie Mae's Desktop Underwriter – dominate the market.[12]

The development of AUS and automated property evaluation systems is a significant advance that, as noted above, is part of the "electronification" of the mortgage process that has benefited and will continue to benefit consumers. They can shorten the time from application for a mortgage to approval from weeks to minutes, facilitate accuracy in mortgage documentation, and

[12] Fannie Mae and Freddie Mac do not expressly require any originator to use their proprietary AUS. However, the dominant position of the two GSEs gives mortgage lenders an incentive to do so. As a general rule, a lender knows that a mortgage accepted by one of the GSE's systems will be accepted for purchase by that GSE. By contrast, a mortgage accepted by an alternative AUS will not necessarily be acceptable for purchase unless it is underwritten a second time, either manually or through one of the GSEs' own proprietary systems. The two GSEs also provide an additional incentive for lenders to use their AUS. They permit an originator that uses a GSE's AUS to sell a loan without the customary representations and warranties that the loan has been underwritten according to that GSE's underwriting standards. This is a valuable incentive. It means that the GSE gives up its contractual right to require the originator to repurchase the loan if it has been underwritten improperly. The waiver of underwriting representations and warranties reduces the originator's risk and the need for capital to absorb the cost of possible repurchases. It also reduces operating costs, since an originator that makes only conforming loans (those eligible for purchase by a GSE) need not do its own underwriting for loans rated "accept" by the GSE's system.

reduce consumers' costs. This shortened time frame is of particular benefit to marginal borrowers. Keeping the processing time for their applications reasonably on par with that of applications for prime loan borrowers removes any incentive for mortgage brokers and loan officers to focus their time on the more quick and easy "slam dunk" applications, to the exclusion of those with some credit obstacles to approval. However, the dominant use of the GSEs' AUS has raised concerns about whether the GSEs are limiting access to the mortgage market for many borrowers because these AUS are perceived to allow lenders less flexibility in considering compensating factors or alternative credit history (e.g., utility bills or rental payments) that would permit disadvantaged borrowers to qualify for conforming loans.

The Urban Institute studied these issues in depth several years ago. Its report, completed in 1999, concluded that the GSEs have made some progress in adding flexibility to their underwriting guidelines, but that "[t]he GSEs' guidelines disqualify a disproportionate share of lower income and minority borrowers. Primary lenders are making more aggressive efforts to serve such borrowers by offering loan products that are more flexible than the GSEs' guidelines."[13] Even without a study, however, it simply stands to reason that multiple underwriting systems that provide alternative and more flexible standards are better for consumers than just two. More competition, more choices.

One reason that the GSEs' systems dominate the current market is that the GSEs have never disclosed their expectations for an acceptable system. Developers of alternative systems are left to guess what parameters drive the GSEs' systems. Moreover, the GSEs do not accept the output of alternative systems on the same basis as that of their own systems, even when the alternative systems is of equal or greater quality.

The GSEs should be required to disclose their standards and accept the output of systems that meet those standards. In addition to promoting competition, such disclosures could help allay concerns about the potential discriminatory impact of the GSEs' systems.

MPF and GNMA Choice Programs

Greater competition in the secondary market for conforming loans will also increase the number of AUS used to underwrite those loans, giving lenders more choices for who will evaluate their loans. This is why we support the Mortgage Partnership Finance program run by the Federal Home Loan Banks and the proposed GNMA Choice program, proposed in S. 1620, the "Home Ownership Expansion Act." (Companion House bill is H.R. 3206.) These programs, each of which provide an alternative secondary market outlet for conventional, conforming loans to the GSEs, represent a solution to the current restrictions on underwriting flexibility caused by the GSEs' current duopoly market – that is, the use of additional private AUS to directly underwrite conventional loans.

We note that among those who would benefit from multiple underwriting systems are minority borrowers who do not meet the standards of the GSEs' AUS, but would meet a more flexible, alternative AUS. Competition, which is colorblind by nature, helps overcome potential disadvantages of using limited underwriting systems.

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[13] Kenneth Temkin, Roberto Quercia, George Galster, and Sheila O'Leary, A Study of the GSEs' Single Family Underwriting Guidelines, The Urban Institute, April 1999, p. 7.

Recovering Home Equity in Foreclosure

Foreclosure is the remedy of last resort for loans in default. The foreclosure process is time-consuming and costly for everyone. The value of a property is discounted when sold at foreclosure, resulting in losses for the lender/servicer and the disappearance of any equity the borrower may have had in the property. Mortgage servicers today employ a variety of loss mitigation tools to avoid foreclosure. In addition to these activities, which may vary among servicers, we support the enactment of a new federal "Homeowner's Equity Recovery Act" (HERA), that would uniformly provide borrowers who are in default, but have equity in their properties, a 90-day period to list the property for sale on the open market, prior to any foreclosure sale. With this kind of sale, the borrower is much more likely to recover his or her home equity, after the loan balance is paid. A notice regarding a consumer's HERA rights would be provided upon the borrower's default.

Ultimate Need for Uniform National Rules

Although real estate has traditionally been regarded as a state law concern, it is clear that mortgage lending is a national industry, where it is routine for lenders to lend in multiple states, for loans and loan servicing rights to be transferred across state lines, and for pools of loans from around the country to be assembled and placed in securities which are sold on the national capital markets. We believe that such a national industry should ultimately have the same, uniform rules that apply to all. Consumers should have the same protections, whether they are in Maine or California, and lenders and servicers should operate on the same, level playing field of regulation across the nation. As you know, state and local governments across the country are enacting or considering legislation that would implement different standards and impose varying levels of prohibitions on lenders. This vastly increases lenders' costs of compliance that are ultimately passed on to consumers through higher mortgage rates. We hope that any federal legislation that is considered addresses these concerns by preempting state and local predatory lending laws while providing the same substantive protections from abusive lending to all consumers.