104

American Association of
Residential Mortgage Regulators

June 24, 2002

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

Attention: Docket No. 2002-17

Dear Sir or Madam:

I am writing on behalf of the Board of Directors of the American Association of Residential Mortgage Regulators (AARMR), a non-profit association of state regulators of mortgage lenders, mortgage brokers, and mortgage servicers. We appreciate the opportunity to provide input regarding the Office of Thrift Supervision's (OTS) proposed rulemaking on the preemption of state law under the Alternative Mortgage Transaction Parity Act (AMTPA).

AARMR is composed of 38 member states and two territories who pool their resources and talents through AARMR to train regulatory staff, coordinate regulatory efforts, conduct joint/concurrent examinations and investigations, share information, coordinate with federal regulatory agencies, and discuss policy issues with industry representatives.

We agree that the purpose of AMTPA was to "enable all housing creditors to provide credit with alternative mortgage vehicles and to preempt state laws that would prevent that type of credit." We also agree that "the OTS prepayment and late fee provisions are not intrinsic to the ability to offer alternative mortgages," and that such provisions are present on conventional mortgages also.

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For these reasons, AARMR supports the proposal to delete Sec 560.34 and Sec. 560.33 from the list of regulations designated for alternative mortgages. We believe that this proposal represents a correct, appropriate and fair consideration of the factors OTS must weigh in determining whether a specific rule should be designated as applicable to state housing creditors.

However, AARMR also recognizes that the appropriateness of applying these two sections of the OTS regulations may differ across depository and non-depository state chartered housing creditors. We agree prepayment penalties and late fee charges may be appropriate loan terms to ensure safe and sound operations in the mortgage lending industry, but can be abusive to consumers in the context of predatory lending. (Please see our attached letter dated September 5, 2001 under the heading "General Comments on Predatory Lending".)

As conveyed in our September 5, 2001 letter, we further concur with the views expressed by OTS that Congress should reconsider AMTPA in the broader context of mortgage reform, that states should be given another opportunity to opt out of preemption provided under AMTPA , and that state housing creditors lending under AMTPA should be required to provide notice to state regulators.

Thank you again for the opportunity to submit comments on the proposed rulemaking. We look forward to continuing to work with you as you formulate your proposal and would appreciate the opportunity to comment further as your proposal evolves.

Sincerely,

Ann Gaultney

A. Ann Gaultney
President

Attachment

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American Association of
Residential Mortgage Regulators

September 5, 2001

The Honorable Ellen Seidman, Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

RE: Comments on Responsible Alternative Mortgage Lending

To Whom It May Concern:

I am writing on behalf of the Board of Directors of the American Association of Residential Mortgage Regulators (AARMR), a non-profit association of state regulators of mortgage lenders, mortgage brokers, and mortgage servicers. We appreciate the opportunity to provide input regarding the Office of Thrift Supervision's (OTS) draft of the proposed rulemaking on Responsible Alternative Mortgage Lending.

AARMR is composed of 38 member states and two territories who pool their resources and talents through AARMR to train regulatory staff, coordinate regulatory efforts, conduct joint/concurrent examinations and investigations, share information, coordinate with federal regulatory agencies, and discuss policy issues with industry representatives.

General Comments on AMTPA and Federal Preemption of State Laws:

Within the draft of the proposed rulemaking, OTS recommends that Congress should revisit AMTPA, possibly in the context of a broader mortgage reform effort that would provide a single set of federal regulations applicable to all entities making home mortgage loans. Such an effort would seem to hold the potential to resolve many of the thorny issues surrounding parity and the unequal powers afforded the various entities making mortgage loans, and would seem to have merit provided that state legislatures are once again provided the opportunity to opt out of the preemption of state law. To fulfill their mission, state regulatory agencies must be given enforcement authority in any such set of federal regulations.

AARMR is supportive of even a broader mortgage legislative review to include Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA) and the Home Ownership and Equity Protection Act (HOEPA). Absent passage of broader mortgage reform, OTS further recommends that states be permitted to revisit the opportunity to opt out of the preemption provided by AMTPA with respect to alternative mortgage transactions. Given that the preemptive effect of OTS regulations has gone far beyond what anyone originally contemplated, it makes sense to revisit the issue. However, it must be noted that opting out of the preemption provided by AMTPA results in a lack of parity between federal

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thrifts and their operating subsidiaries, on the one hand, and state-licensed housing creditors on the other. Significantly, since most states now allow housing creditors to make alternative mortgages, the lack of parity would not be present in the ability to make alternative mortgages, but rather in the ability of state-licensed housing creditors to charge prepayment penalties and profit from other ancillary fees or loan features. This fact emphasizes that it is the absence of effective consumer protections in federal regulations, and the federal preemption of such provisions in state law, that creates a lack of parity in the marketplace.

Finally, OTS recommends that in the absence of broader mortgage reform, state-licensed housing creditors lending under the preemptive authority of AMTPA should be required to identify themselves to the states. AARMR believes that such a requirement would be helpful.

General Comments on Predatory Lending:

AARMR continues to believe that predatory lending results primarily from the use of unfair and deceptive sales practices in the origination and sales of mortgage loans. Specific loan terms, in and of themselves, are not predatory, but become predatory when paired with unfair and deceptive sales practices. For example, a prepayment penalty becomes predatory when a lender sells the consumer a high-interest-rate, high-cost loan by telling them that they can refinance to a lower interest rate in one year, at the same time hiding the existence of a prepayment penalty that makes it uneconomical to refinance the loan in one year. In this way, a large prepayment penalty can lock the borrower into an unfavorable loan and is predatory.

It is AARMR's view that to effectively address predatory practices in mortgage lending, regulators must take three steps. First, disclosures must be simplified so that consumers can use them to quickly and easily get the information they need to evaluate the cost and terms of their loan. The U.S. Department of Housing and Urban Development (HUD) and the Federal Reserve System (Fed) have made proposals in this regard in their joint report on the issue, but no further action has been taken. Secondly, prohibitions against specific unfair and deceptive acts and practices must be placed in our laws and regulations, with harsh penalties for violations and provisions that allow consumers a private cause of action. Third, regulatory agencies must have the regulatory authority and resources to aggressively pursue enforcement of these prohibitions against mortgage lenders and mortgage brokers who employ unfair and deceptive practices in the origination of mortgage loans.

Unfortunately, we note that the current proposed rulemaking from OTS does not contain any such provisions. We understand the concern OTS expressed that including prohibitions against unfair and deceptive acts or practices in their proposal might result in further preemption of such prohibitions in state law. We believe that such further preemption of state law could be prevented through appropriate drafting of the language. Such an approach might include clauses that limit the applicability of such preemption if such prohibitions exist in state law or limit the preemptive effect of the rule if state law contained more stringent prohibitions.

Specific Comments upon the OTS Proposal:

The OTS proposal contemplates the following amendments to the regulations implementing the Alternative Mortgage Transaction Parity Act (AMTPA):

- Revise Sec. 560.34 to incorporate new restrictions on prepayment penalties for "covered loans", but continue with the general practice of allowing the lender to establish a prepayment penalty subject to the terms of the loan contract for all other loans.
- Add Sec. 560.180 to establish criteria for loan underwriting and documentation.
- Add Sec. 560.215 to define "covered loans" and to condition the use of prepayment penalties on such loans.
- Amend Sec. 560.220 to include the new sections in regulations that state-licensed housing creditors can access and to exclude from the definition of an alternative mortgage transaction any loan that is alternative in nature only because of an adjustment triggered by a borrower's default on a loan term.

Underwriting and Documentation Proposal:

Under the OTS's underwriting and documentation proposal, the existing requirements for underwriting and documentation of loans by federal thrifts are collected in one regulation. These provisions require that the lender evaluate the borrower's creditworthiness, determine the borrower's ability to repay the loan, determine the market value of the property, consider the borrower's equity in the property and the impact of any loan fees on that equity, and evaluate any secondary sources of repayment or additional collateral enhancements.

As a general matter, except as required under HOEPA or under certain states laws, a non-depository lender is not required to determine a borrower's ability to repay the loan. Establishing a requirement that all mortgage lenders, both depository and non-depository, document the borrower's ability to repay the loan is a positive step. As of this writing, we do not fully understand the full implications of subjecting state-licensed housing creditors to the full complexity of the OTS regulations. We remain unsure about the full scope of those regulations, the extent to which they would preempt existing record keeping requirements and other requirements in state law, and the additional training requirements the proposed rule would place upon state regulators. For these reasons, we request further clarification on this issue and reserve the right to comment more fully after we more completely understand the implications of this proposal.

We are concerned, however, that the OTS underwriting and documentation standards were developed to implement a regulatory mission to ensure the safety and soundness of depository financial institutions. It is unclear to what extent the new rule will improve consumer protections. The rule does reference the appraisal and real estate lending standards expressed in other OTS regulations. While these standards may be wholly appropriate for depository institutions that benefit from coverage under a federal deposit insurance program, we request clarification as to how they would be appropriate for non-depository institutions where the regulatory mission is one of ensuring compliance with consumer protection laws, not safety and soundness of the regulated entity.

This is of particular concern when one notes the differential impact of non-compliance on federal thrifts and state-licensed housing creditors, respectively. If a federal thrift or its wholly owned subsidiary fails to comply with a technicality of the underwriting and documentation provisions of the new regulation, presumably OTS will note this in the institution's report of examination and the thrift or subsidiary will be given ample time to correct the problem. At worst, a write-off of loans or some fine

may be mandated. However, if a state-licensed housing creditor fails to comply with a technicality of the underwriting and documentation standards, and fails to correct the problem within sixty days of notification, the state-licensed housing creditor loses access to the preemptive authority within the regulations. In that case, all of its loans may have been made in violation of state law. The state-licensed housing creditor becomes exposed to aggressive enforcement action from its state regulator, potentially including fines and revocation of license, and perhaps more importantly, exposure to civil liability and class action lawsuits. This does not appear to provide the parity Congress had in mind when it enacted AMTPA.

Prepayment Penalty Proposal:

OTS proposes to continue to allow lenders to impose a prepayment penalty on a mortgage loan subject to the terms of the loan contract. However, OTS proposes to define a "covered loan" and to condition the use of a prepayment penalty on such loans.

- A "covered loan" is defined as:
- An alternative mortgage transaction as defined by 12 U.S.C. Sec. 3802 and revised Sec. 560.220;
- A home equity loan or a refinanced residential mortgage loan; and,
- A loan that triggers the Home Ownership Equity Protection Act (HOEPA) fee limits when the consumer's maximum prepayment penalty is added together with the other fees paid by the consumer.

When a lender makes a "covered loan", OTS proposes to condition its use of prepayment penalties in the following two ways. First, the lender must concurrently offer the borrower an alternate loan for the same amount without a prepayment penalty but with the same characteristics, including maturity date, amortization schedule, closed or open end, and the down payment, as the initial loan with a prepayment penalty. Second, for any prepayment penalty that is in effect for three years or longer, the terms of the contract must include a written commitment to end the prepayment penalty after the borrower has made 24 consecutive timely payments on the loan. A payment is considered timely for purposes of this section if it is made within the period during which a late charge cannot be imposed under 12 CFR 560.35.

AARMR commends OTS for taking steps to enhance consumer protection within its mortgage lending regulations. However, we do not believe that these proposals will have a significant impact in reducing predatory lending. First, rather than simplifying matters, the new definition will add greater complexity, establishing a new class of loan in addition to the "high cost loan" defined under HOEPA. With respect to alternative mortgages, our examiners and the industry will now have to puzzle through the two definitions, determine which definition applies to any given loan, and what the ensuing requirements would be. We are unsure whether any conflict would arise if a loan were to be both a "high cost loan" as defined under HOEPA and a "covered loan" under the regulation OTS is proposing.

In regard to the requirement that lenders offer borrowers an alternative mortgage without a prepayment penalty, we believe that predatory lenders will simply offer them an alternative loan that is so costly consumers would never accept it, or simply employ unfair and deceptive sales practices to ensure that consumers accept the loan with the prepayment penalty. We believe that this proposal will have no significant impact on the incidence of predatory lending.

With respect to the proposal that the lender end the prepayment penalty after the borrower has made 24 consecutive timely payments, AARMR believes that the proposal has some merit, but again will have little impact on the incidence of predatory lending. AARMR believes that a more effective proposal would tie the prepayment penalty to violations of prohibitions on unfair and deceptive acts and practices. Under such a proposal, the lender would be forced to end the prepayment penalty, or return any prepayment penalty already paid, upon a violation of the prohibitions against unfair and deceptive acts and practices. This would allow the consumer who was tricked into accepting a high cost mortgage the opportunity to refinance out of the loan and recoup or avoid the prepayment penalty. In addition, we urge OTS to consider some overall limitation on the maximum amount that may be charged as a prepayment penalty and/or some limitation on the maximum period on the term during which a prepayment penalty may be applied.

AARMR heartily supports the proposal to exclude from the definition of an alternative mortgage any loan that is alternative in nature only because of an adjustment triggered by a borrower's default on a loan term. This amendment will go a long way toward preventing predatory lenders from abusing the preemption of state law allowed under AMTPA and the OTS regulations. We urge OTS to also consider excluding from the definition of an alternative mortgage any loan that is alternative in nature only because of an adjustment due to the borrower's good payment history.

Thank you again for the opportunity to submit comments on the draft of the proposed rulemaking. We look forward to continuing to work with you as you formulate your proposal and would appreciate the opportunity to comment further as your proposal evolves.

Sincerely,

A. Ann Gaultney

A. Ann Gaultney
President

cc: Deborah Dakin
AARMR Board of Directors
Neil Milner, President and CEO, CSBS
Leslie Pettijohn, Chair, Legislative Committee, NACCA

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