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COMMENTS

of the

NATIONAL CONSUMER LAW CENTER
and
CONSUMER FEDERATION OF AMERICA

to the

Office of Thrift Supervision

Re: Notice of Proposed Rulemaking
Docket Number 2002-17
RIN 1550-AB51

12 C.F.R. Part 560, 590 and 591

June 24, 2002

The National Consumer Law Center submits the following comments on behalf of its low income clients and the Consumer Federation of America to the Office of Thrift Supervision regarding the proposed amendment of the regulations issued pursuant to the Alternative Mortgage Transactions Parity Act.[1]

First, we would like to commend and support the OTS for proposing that prepayment penalties

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[1]The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, (4th ed. 1999) and Cost of Credit (2nd ed. 2000) and Repossessions and Foreclosures (4th ed. 1999) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC became aware of predatory mortgage lending in the latter part of the 1980's, when the problem began to surface in earnest. Since that time, NCLC has written extensively on the topic, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to defend against such loans, and provided extensive oral and written testimony to numerous Congressional committees on the topic. NCLC's attorneys were closely involved with the enactment of the Home Ownership and Equity Protection Act in Congress, and the initial and subsequent rules pursuant to that Act. Additionally, NCLC was a primary author of the AARP model bill on predatory lending, http://research.aarp.org/consume/d17346_loan_1.html, which is the basis for most of the state legislation to address predatory lending considered in dozens of states over the past few years and passed in several. In addition, representatives of NCLC have actively participated with industry, the Federal Reserve Board, Treasury, and HUD in extensive discussions about how to address predatory lending. These comments are authored by Margot Saunders, Managing Attorney, National Consumer Law Center, Margot@NCLCDC.org.

The Consumer Federation of America is a nonprofit association of nearly 300 pro-consumer groups in forty five states, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

and late fees be excluded from the list of provisions which are preempted from state limits on alternative loans made by state housing creditors. If made final, the proposed regulation will significantly reduce predatory lending by allowing the imposition of existing and new limitations on prepayment penalties on home mortgage loans. While the regulation of late fees has received considerably less attention than prepayment penalties – because the amount of money charged for late fees in mortgage loans is generally in incremental amounts – there are increasing problems with predatory lenders overcharging on late fees. It is entirely appropriate and necessary for OTS to adopt the proposed regulations removing the authority under the Alternative Mortgage Transaction Parity Act (the "Parity Act"),[2] for state housing creditors to charge these fees without regard to state law.

Another purpose of these comments is to request that OTS formally clarify the application of the Parity Act to state housing creditors. It is particularly important for OTS to articulate – again – the process to determine whether a particular provision of state law is preempted with respect to certain loans made by certain creditors. While OTS has articulated this progressive analysis in a number of its regulations and formal letters, there is still confusion on this issue. This confusion is evident from the overreaching interpretations applied in a number of recent court decisions.[3]

I. OTS is Acting Legally and Appropriately by Deleting the Provisions Relating to Prepayment Penalties and Late Fees from Parity Act Application to State Housing Creditors.

By proposing to remove regulations relating to prepayment penalties and late fees from Parity Act treatment for state housing creditors, OTS is fulfilling its responsibility to carefully evaluate the state law provisions which must be preempted to facilitate an adequate supply of alternative mortgage credit, while limiting the preemptive effect of its regulations so as to protect consumers from over-reaching creditors.

No doubt many in the mortgage industry will argue that OTS would be wrong to remove provisions relating to prepayment penalties and late fees from Parity Act treatment. The industry will argue strenuously that if these provisions are removed state housing creditors will not have equal parity with federal lenders in the making of alternative mortgages, and as a result fewer alternative mortgages will be made, thus negating the intent of the Parity Act.

However, it was never the intent of the Parity Act to provide complete parity between the federally regulated institutions and the state housing creditors addressed in the Parity Act. Rather the Parity Act is simply a limited authorization to three federal agencies to determine which provisions applicable to their regulated entities are appropriate to apply to state housing creditors for the limited purpose of making alternative mortgage loans.[4]

In 1982, Congress passed the Parity Act to boost the dwindling supply of home mortgage credit in

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[2] 12 U.S.C. § 3801 et seq.,

[3] *See e.g. National Home Equity Mortgage Ass'n v. Face*, 239 F.3d 633 (4th Cir. 2000); *Shinn v. Encore Mortgage Services, Inc.*, 96 F.Supp. 2d 419 (D.N.J. 2000).

[4] 12 U.S.C. § 3801(b).

the 1980s.[5] The idea was to expand the amount of credit available by relieving – in carefully delineated circumstances – state housing creditors from complying with certain limitations in state law imposed on alternative mortgage transactions.

To gain perspective on the very limited parity that Congress intended to provide between state housing creditors and federal depository institutions it is helpful to recognize what Congress *did not* do when the Parity Act was passed. Congress could have – but did *not* – simply preempted all state rules on alternative mortgages as it had done two years earlier for state interest rate limits on first mortgages in the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA").[6] Congress could have – but did *not* – automatically apply to state housing creditors the limited preemption of state rules provided to federally regulated institutions for alternative mortgages under the laws governing national banks, federally chartered savings and loans, and federal credit unions. Congress could have – but did *not* – authorize the federal agencies to apply their rules for federal institutions applicable to alternative mortgages to state housing creditors on a blanket basis. Instead, Congress established in the Parity Act, a carefully orchestrated, iterative process by which the federal agencies should determine exactly which federal rules should be applied to state housing creditors who are making alternative mortgages, and are otherwise complying with state licensing and regulatory requirements.[7]

Clearly Congress intended for OTS to evaluate carefully which state law provisions state housing creditors should be allowed to avoid when making alternative loans. Implicitly, since OTS has ongoing responsibility under the Act, OTS is also required to monitor the effect of its actions under the Parity Act. It is entirely appropriate, therefore, for OTS to consider the impact on both consumers and the mortgage market of the Parity Act treatment of specific loan provisions applicable to alternative mortgage loans.

While Congress intended some parity for housing creditors making alternative loans, clearly Congress did not intend that state housing creditors making alternative loans should be covered by the *exact* same rules as federal lenders – otherwise Congress would have simply provided for this. Instead, OTS is implicitly tasked with the dual obligations to ensure 1) that state housing creditors have sufficient parity with federal thrifts to facilitate alternative mortgages free from overly restrictive state regulations, and 2) the freedom from state restrictions on alternative mortgages does not have negative consequences either on the marketplace or on consumers.

As OTS has noted in this Proposed Regulation,[8] neither prepayment penalties nor late fees are loan provisions which are intrinsic to alternative mortgages. Put another way, it is not necessary for a lender to be free from state restrictions on prepayment penalties or late fees in order for the lender to be able to make alternative mortgages. Congress defined the universe of alternative mortgages in 12 U.S.C. Section 3802 but left it to the federal regulators to define precisely which terms of alternative mortgages enjoy the

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[5] 12 U.S.C. § 3801(a).

[6] 12 U.S.C. § 521-523, 525 -529 (1980).

[7] 12 U.S.C. § 3801 note.

[8] OTS Notice of Proposed Rulemaking, No. 2002-17, 67 FR 20468.

benefit of the preemptive effect offered by the Parity Act.[9]

The Parity Act was only enacted to allow for the preemption of those state law provisions which actually *interfere* with the making of alternative loans. These provisions are meant to be specifically identified by the federal regulators as market and other conditions dictate.

OTS has already recognized in the 2000 Advance Notice of Proposed Rulemaking that there are substantial problems of predatory lending in the mortgage marketplace and that state housing creditors may be somewhat responsible for these problems.[10] As estimated by the Coalition for Responsible Lending and the Self-Help Credit Union, 80% of all sub-prime loans (both alternative and fixed-rate) carry prepayment penalties. The prevalence of these prepayment penalties – due to OTS's current interpretation of the Parity Act – along with other prejudicial loan terms, strips $1.3 billion in home equity annually from half a million families.[11]

It is therefore not necessary for OTS to identify provisions on prepayment penalties and late fees in order to facilitate alternative mortgages made by state housing creditors. In fact, the identification of these provisions serves mainly to facilitate predatory practices among some lenders. OTS should adopt the Proposed Rule. If OTS makes the Proposed Rule on prepayment penalties and late fees final, millions of homeowners will benefit from this courageous and correct position.

II. OTS Should Take This Opportunity To Clarify the Limited Role that Parity Act Identified Provisions Have on Lending by State Housing Creditors

Despite the Parity Act itself and consistent OTS statements in various writings, there is still substantial confusion about the exact effect of the identification of specific types of provisions in 12 C.F.R. § 560.220. There are three, related but distinct, issues which need specific clarification by OTS. The final rule issued pursuant to the present Proposed Rulemaking is the opportune time for OTS to address these questions. OTS should provide the following clarifications:

1) By identifying prepayment penalties and late fees for Parity Act treatment in the existing regulations (12 C.F.R. § 560.220), OTS does not intend that a loan which is otherwise *not* an alternative mortgage transaction, may achieve AMT status and preempt state law limitations, simply by including a prepayment penalty or late fee.

2) Parity Act preemption applies only if the transaction meets one of the definitions of alternative mortgage transaction in the Act (12 U.S.C. 3802(1)), and then allows state housing creditors to avoid state law limits only on the specific terms identified by OTS regulations.

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[9] The federal court's careful analysis of the scope of the Parity Act in *Ansley v. Ameriquest Mortgage Co.*, 194 F.Supp.2d 1062, 1065 (C.D. Cal. 2002), supports this interpretation. The court held that "[t]he Parity Act does not control every alternative mortgage transaction issued by every creditor in every situation," but rather it covered only those AMTs that are authorized by the OTS.

[10] 67 F.R. 20468, 20470 (2002).

[11] *See* Martin Eakes and Eric Stein, *Solutions to Parity Act Facilitation of Finance Company Abusive Lending Practices.* (Coalition for Responsible Lending Issue Paper, March 19, 2002).

3) State housing creditors must still comply with other state laws relating to mortgages. OTS regulations under the Parity Act only exempt alternative mortgages made by state housing creditors from state statutes governing the specific terms identified.

These issues are complicated but obviously quite important to clarify.

1) Provisions Authorizing Prepayment Penalties and Late Fees Do Not *Make* a Loan Alternative.

On the first issue, OTS has said that the effect of identifying prepayment penalties and late fees for Parity Act treatment is simply to allow state housing creditors to avoid state limitations on prepayment penalties and late fees for loans which are otherwise defined as alternative.[12] Nevertheless, as OTS has recognized in the present Proposed Regulations, many in the mortgage industry, as well as some courts, misunderstand that the existence of either a prepayment penalty or a late fee in a mortgage contract does not *make* the loan an alternative loan.[13]

Whether or not OTS adopts the Proposed Regulation changing the treatment of prepayment penalties and late fees for alternative mortgages, it is important that OTS clarify that the existence of provisions in a loan allowing prepayment penalties or late fees does not qualify the loan for Parity Act treatment. The loan must still fit the definition of alternative under the Parity Act by including a variable rate, for example. Some courts seem to have misconstrued the limited application of OTS' identification of prepayment penalties. This misunderstanding is evident from language which may be simply *dicta* in the recent case of *National Home Equity Mortgage Ass'n v. Face* from the Fourth Circuit Court of Appeals,[14] yet the mortgage industry lauds this as black letter law:

> In sum, we hold that *non-federally chartered housing creditors in Virginia* – as they are defined in 12 U.S.C. § 3802(2) – may elect to have their alternative mortgage transactions governed by the federal law applicable to federally chartered housing creditors engaging in similar transactions by complying with that law, and when they do, that law, which includes 12 C.F.R. § 560.34 (regulating prepayments and authorizing a prepayment fee), preempts Virginia Code . . . , which limits the imposition of prepayment penalties.

239 F.3d at 640.[15]

OTS should clarify that its identification of prepayment penalties and late fees in its Parity

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[12] *E.g.* Advance Notice of Proposed Rulemaking, April 5, 2000, 65 F.R. 17811, 17815 (2000); OTS Legal Opinion 97 - 1 (February 10, 1997).

[13] *See, e.g., National Home Equity Mortgage Ass'n v. Face*, 239 F.3d 633(4th Cir. 2000); *Shinn v. Encore Mortgage Services, Inc.*, 96 F.Supp. 2d 419 425 (D.N.J. 2000).

[14] 239 F.3d 633(4th Cir. 2000).

[15] *Also see, Shinn v. Encore Mortgage Services, Inc.*, 96 F.Supp. 2d 419 at 425 (D.N.J. 2000):

> [T]he Court finds that § 3803(c) does not limit the preemptive effect of the Act to state laws which would completely prohibit or obstruct the creation of AMTs.

96 F. Supp. 419 at 435.

Act regulation simply allows state housing creditors to avoid state limits on these provisions if the loans otherwise qualify as alternative under the Parity Act.

Clearly, provisions relating to prepayment penalties and late fees do not qualify loans as alternative under either the statute or the regulations – because these provisions do not fit within any of the three subsections of the statutory definition. Loans with prepayment penalties or late fees are not variable rate loans, they are not balloon payment loans, and they are certainly not loans with terms "not common to fixed-rate, fixed-term transactions."[16]

Prepayment penalties are common in non-alternative mortgages, and late fees are ubiquitous in all mortgages.[17] *Clearly, OTS could not have intended that a mortgage which is not otherwise alternative* would become alternative just because it has a provision authorizing a fee for a late payment in it. By identifying these two provisions – OTS should clarify that it meant to allow lenders to impose these terms without regard to state law restrictions only in loans which can be described as alternative under the Parity Act.[18]

2) OTS Must Identify Which Provisions in Alternative Mortgages are Accorded Preemptive Treatment Under the Parity Act.

Congress defined the universe of alternative mortgages in 15 U.S.C. § 3802, but left it to the federal regulators to define precisely which alternative mortgages enjoy the preemptive effect offered by the Parity Act:

> (1) The term 'alternative mortgage transaction' means a loan or credit sale secured by an interest in residential real property . . . –
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> (A) in which the interest rate or finance charge may be adjusted or renegotiated;
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> (B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or
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> (C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, . . . ;

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[16] 12 U.S.C. § 3802(1)(C).

[17] *See* Freddie Mac's website, which provides a generic "MULTISTATE FIXED RATE NOTE." Within that document is a late charge provision: **http://www.freddiemac.com/uniform/**. Additionally, in its glossary of mortgage terms, Freddie Mac describes the typical range of late fees as 1 to 5 percent of the monthly payment. *See,* "Late-Fee Assessment Date" **http://www.freddiemac.com/finance/smm/g_m.htm#L**.

[18] OTS deferred to the description of alternative loans for the braod question of the definition of an alternative loan: "Pursuant to 12 U.S.C. 3803, housing creditors . . . may make alternative mortgages as defined by that section . . .." 12 C.F.R. § 560.220.

described and defined by applicable regulations."[19] (Emphasis supplied).

The words "described and defined" apply to all three types of alternative mortgages identified by the statute. Thus, OTS's definitions can both potentially limit or expand the description supplied by the statute. The key here is that OTS has the duty of describing and defining *which* of the alternative mortgages identified by Congress will enjoy the benefits of preemption from state limits on certain provisions. In other words, while Congress identified – for example – a variable rate mortgage as a candidate for Parity Act preemption, it simultaneously permitted the regulators to choose whether to include or exclude variable rate mortgages.

As a result of the Congressional directive to *describe and define* in 12 U.S.C. § 3802(1), OTS has the duty to delineate *which* alternative mortgages should be given the preemptive treatment afforded by the Parity Act. First one looks to the three definitions in the Parity Act to see if the loan is defined there as alternative – having an adjustable rate,[20] a balloon payment provision,[21] or any provision which is "not common to fixed-rate, fixed-term transactions."[22] *Then*, one looks to see which terms of alternative mortgages are provided preemptive treatment for state housing creditors by OTS in the Parity Act regulation.

OTS has identified variable rate provisions in alternative mortgages in 12 C.F.R. Section 560.220 as subject to Parity Act preemption from state law restrictions.[23] However, OTS has *not* identified balloon notes, negative amortization clauses or shared appreciation terms as alternative.[24] There can be only one reasonable interpretation on this deliberate deletion of these specific provisions: Alternative loans with provisions which are not specifically identified by OTS in Section 560.220 must comply with state law limitations for those provisions.

The Final Rule would be a good time for OTS to clarify that this is the intent of *not* including specific provisions relating to alternative mortgages.

3) OTS Should Articulate that State Housing Creditors Must Comply with All State Laws Relating to Alternative Mortgages *Except* Those that OTS Has Specifically Identified.

The Parity Act clearly requires that mortgage lenders must comply with certain state law

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[19] 12 U.S.C. § 3802(1)(A), (B), and (C), respectively.

[20] 12 U.S.C. § 3802(1)(A).

[21] 12 U.S.C. § 3802(1)(B).

[22] 12 U.S.C. § 3802(1)(C).

[23] In fact, OTS specifically *included* variable rate loans as a type of alternative mortgages which qualify for coverage under the Parity Act. 12 C.F.R. § 560.220, referring to § 560.35.

[24] As OTS has recognized in the instant Proposed Regulations, some of these provisions had been specifically identified in the 1983 Parity Act regulation, but were specifically omitted in the 1996 rewrite. 61 FR 50951, at 50955, and 50969 (September, 1996).

requirements in order to qualify as state housing creditors:

> A person is *not* a "housing creditor" with respect to a specific alternative transaction . . . unless such person remains, or becomes, subject to the *applicable regulatory requirements and enforcement mechanisms provided by State law.* (Emphasis added.)[25]

This should mean that *all* state law provisions *except* those which are specifically included in Parity Act treatment apply to alternative mortgages. Despite this, the industry has often argued that once a loan qualifies as alternative under the Parity Act it is free from all state law. Clearly this cannot be the case, as this would provide state housing creditors with greater exemptions from state law than are enjoyed even by federal depository institutions. Pursuant to OTS' own regulation on thrifts, even after asserting "field preemption" over all state laws relating to lending by savings and loan associations, OTS lists a series of state laws which are always applicable to these lending activities, including contract and commercial law, real property law and criminal law.[26]

OTS has also articulated the applicability of these laws to mortgages made by savings and loan associations in several legal opinions.[27] Again, the Final Regulation is an ideal opportunity for OTS to clarify this issue.

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[25] 12 U.S.C. § 3802(2).

[26] 12 C.F.R. § 560.2(c).

[27] The OTS has opined that Indiana's Deceptive Acts and Practices law, which covered deceptive practices in consumer lending, was not preempted by 12 C.F.R. § 560.2 and, therefore, covered federal savings associations. OTS Legal Opinion 96-15. Likewise, while the OTS found that certain provisions of California's Unfair Competition Act were preempted, it emphasized "the extremely limited nature" of its analysis and wrote that "[w]e do not preempt the entire UCA or its general application to federal savings associations in a manner that only incidentally affects lending...." OTS Legal Opinion 99-3.