National Home Equity Mortgage Association

30

1301 Pennsylvania Avenue, NW
Suite 500 • Washington DC 20004
(202) 347-1210
FAX: (202) 347-1171
http://www.nhema.org

NHEMA

June 14, 2002

Writer's Direct Address:
Maurice L. Shevin, Esq.
Sirote & Permutt, P.C.
P. O. Box 55727
Birmingham, AL 35255-5727

VIA FACSIMILE - 202/906-6518
VIA EMAIL - *regs.comments@ots.treas.gov*
VIA U.S. MAIL

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

Re: Docket No. 2002-17

Gentlemen:

Please accept this comment letter on behalf of the National Home Equity Mortgage Association ("NHEMA") – the largest trade association of home equity lenders in the nation. The mission of our Association is to foster, maintain and enhance the home equity lending industry's ability to provide consumers access to mortgage credit in a fair and ethical manner. Our members make home equity mortgage loans to borrowers in every state in the United States, the District of Columbia and territories of the United States. Our members are both depository and non-depository institutions, some exceedingly large, and others limited in size to operations in only a few states. Because of our diversity, one or more of our members is regulated by every federal agency concerned with consumer mortgage lending, as well as each state's financial institutions regulatory agency. As the trade association for this diverse group of lenders, we feel that we are well suited to speak to the Notice of Proposed Rulemaking that would alter the current preemption of state imposed prepayment penalties with respect to mortgage loans made by state-chartered housing creditors.

ABOUT US

Our Association is intimately familiar with the national debate involving non-prime mortgage lending, that has too commonly been referred to as "predatory lending." As those government, consumer and industry members most familiar with mortgage lending have clearly said, non-prime lending is not predatory lending. Members of NHEMA abhor predatory lending practices. Our membership has adopted a Code of Ethics and Best Practices Standards that categorically reject any questionable lending practices. Our Association has participated in the various initiatives of the federal agencies, beginning with the HUD task force known as the Mortgage Reform Working Group, continuing with the giving of testimony at the HUD/Treasury inter-agency hearings conducted primarily during calendar year 2000, and continuing to this date through the offering of comments and suggestions for legislation and regulation.

Sub-prime lending is not synonymous with predatory lending. Members of our industry are highly offended by the implication that all lenders offering loans to non-prime consumers operate in some illegal or unethical manner. Rather than being predators, our lenders have made credit available at affordable costs, to millions of Americans, including those in under-served markets. By definition, a predatory lender would seek out the highest risk borrower, to make a loan with the least chance of repayment, so that the predatory lender could take the borrower's home. However, as an industry, non-prime lenders have very high loan denial rates, non-prime borrowers have as much or more equity than prime borrowers have, and our foreclosure rates are no higher than those of prime lenders. In addition, our borrowers look like the population of the United States. Our home equity borrowers are black, white, Hispanic and Asian in the same percentages as the entire nation.

THE DEMOCRATIZATION OF CREDIT

The success of home equity lenders has been good, not because of discriminatory practices, but because of sound, entrepreneurial business practices. Our membership was the first to democratize credit and make it available to a traditionally under served segment of the public. When the federal government wisely deregulated the mortgage lending industry, and many state governments followed suit, the world of economic freedom and opportunity for borrowers was opened. As a consequence, we are at a markedly different place than we were 20 years ago. Access to the equity in one's property and home has given opportunity to borrowers to make meaningful life style decisions such as college for children, funds to start a business, money to travel or make home improvements, and countless other individual, unique and personal choices.

The enviable position that America's consumers find themselves in today did not come about by shear luck. Rather, a concerted effort by government leaders over the last 20 years to expand credit opportunity has gotten us here. A very important element in our achievement has been the preemption of state law limitations on prepayment penalties afforded to all lenders via the

Alternative Mortgage Transactions Parity Act, passed in 1982 (the "Parity Act"). Prior to passage of the Parity Act, there had been efforts by the federal regulators to increase the availability of credit by allowing federally-chartered lenders to offer alternative mortgage transactions ("AMT's"). Although federally-chartered lenders such as national banks, federal thrifts and national credit unions were entitled to make AMT's, many states had laws which prevented state-chartered housing creditors from making AMT's. Thus, Congress enacted the Parity Act in order to:

> authorize non-federally chartered housing creditors to offer alternative mortgages in accordance with Federal regulations issued by the appropriate Federal regulatory agencies. Thus, those creditors will have parity with federally chartered institutions.

Sen. Conf. Rep. No.97-641 at 94 (1982). Accordingly, the Parity Act was passed to "level the playing field" between federally-chartered lenders and state-chartered lenders. In paragraph (b) of the preamble accompanying and explaining the statute, Congress said:

> (b) It is the purpose of this chapter to eliminate the discriminatory impact that those regulations have upon non-federally 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 USC Section 3801.

WHY YOUR PROPOSED CHANGE IS ILL-ADVISED

1. The intent of Congress and the actions of the OTS in carrying forward this intent for the last twenty years, was and has been to make more housing credit available by giving state-chartered housing creditors parity with federally-chartered institutions, and eliminating the discriminatory impact of state law. This mission has been accomplished in part by the OTS Regulations. That is, just as federally-chartered lenders need not be concerned about certain restrictions of state laws in their lending processes, state housing creditors similarly need not be concerned. The notable

example, and the one that is the subject of this comment, is prepayment penalties. However, the change proposed by the OTS in the existing Regulation (the "Proposal") will negatively affect the balance that has been achieved over the many years, and will negatively impact housing credit availability.

There is no question but that prepayment penalties play an important role in the pricing of mortgage loan products. If one set of lenders (those federally chartered) may ignore the impact of prepayment penalties within a given state, while another set of lenders (state housing creditors) may not, we have disparate and unequal treatment. This is not a matter of loss of prepayment penalty income as you suggest. Rather, we are concerned with losing business because of the competitive advantage that federally-chartered housing creditors will enjoy by continuing to offer their loan products at a lower initial interest rate, based upon the safety net of a prepayment penalty. It is patently absurd for the OTS to argue that state housing creditors can "ameliorate" loss of income by substituting points or simply raising rates. Even if competitive equality in the ability to offer loan products was not the issue, state housing lenders would have to be concerned on a state by state basis with the possibility that points are capped by state law. And, of course, the parties who will suffer the most from this inequitable treatment will be America's consumers. State law compliance cost resulting from the Balkanization of lending in the United States will make housing credit more expensive.

Mortgage lending is now conducted on a nationwide basis, not merely on a local basis. For one set of lenders to be able to ignore the differences in statutory prepayment limitations among the states, while the other set must comply, creates a serious disadvantage for those state-chartered housing creditors who operate nationwide. Such a change in the rules offends the intent of Congress in passing the Parity Act.

Your suggestion of substituting points for prepayment penalty does a huge disservice to the borrowing public. A "point" is an immediate, out of pocket cost to a borrower. That cost is fixed regardless of whether the borrower keeps the loan for its full term, or chooses to prepay or refinance the loan at some earlier date. By contrast, a prepayment penalty does not necessarily cost the borrower anything. That is, if the borrower carries the loan to term (or more often through the period of the restriction on prepayment without penalty), there is no cost to the borrower associated with the prepayment penalty at all. Even assuming that the average loan will prepay, and cost the borrower some prepayment penalty, we submit that such costs in the aggregate are less than will be paid by borrowers to lenders who would be forced to "ameliorate" their losses if the Proposal is implemented. The fact of the matter is that prepayment penalties reduce settlement costs; they do not enlarge settlement costs.

Finally, the OTS should be mindful of the experience suffered by the home equity industry when Wall Street determined that loan portfolios without sufficient restriction on prepayment, were a dangerous commodity. The secondary market demands certainty. Prepayment penalties bring that certainty to the table.

2. Federally-chartered lenders are subject to oversight for safety and soundness. State housing creditors, too, are subject to regulatory scrutiny. In fact, those state housing creditors that operate on a nationwide basis are generally subject to far more agency review than are their federally-chartered counterparts. Of course, the federal disclosure regimen vis-a-vis the consumer, for both sets of lenders is generally the same. The Federal Reserve Board's Regulation Z already requires the disclosure of a prepayment penalty. § 226.18(k). Some states, however, impose more stringent and additional disclosures on state housing creditors than they do on federally-chartered institutions.

3. The 1996 interpretation of the Parity Act Rules by the OTS resulted in exactly the kind of advance in housing credit that Congress intended. When it became clear to state housing creditors that preemption from state prepayment penalties was within the ambit of the Parity Act protections and available to them, state housing creditors moved promptly into states where they had not been before. Our members tell us that they could then begin to offer their AMT loan products in competition with federally-chartered lenders in Michigan, New Jersey, Ohio, Illinois, North Carolina, Virginia and other states, with the certainty that is critical to lenders. Your Proposal would negate the ability of state housing creditors to continue to offer AMT's in those states on a competitive basis.

You state that prepayment penalties are not "intrinsic" to the ability of state-chartered housing creditors to offer AMT's. While perhaps not intrinsic, the loss of a prepayment penalty provision significantly impairs the ability of a state housing creditor to compete in the offering of an AMT product.

4. We are most surprised that the OTS would undertake such a significant change in the regulatory regimen when admittedly, it has no information on how many state-chartered housing

creditors rely upon the Parity Act. You estimate that there are some 6,000 state housing creditors and that approximately $15 billion of adjustable rate mortgages were written in 2001 and 2002. How many of these loans were made by housing creditors with prepayment penalty provisions, in reliance on the Parity Act? How many of these loans were AMT's that are non-adjustable rate mortgage loans? How can you undertake to change a Rule that impacts such a vast number of loans and such a huge dollar amount without a serious effort to study and to describe the impact of the change? If, as we suspect, a large number of these loans were written in partial reliance upon the enforceability of prepayment penalties, your proposed change will have drastic consequences. We respectfully submit that you have failed to meet the regulatory burden to assess the impact of the proposal under the Regulatory Flexibility Act.

5. Congress' goal in passing the Parity Act was to expand housing credit by creating a competitive environment wherein state housing creditors on a parity with federally-chartered institutions could make AMT's without regard for conflicting state laws. This goal has certainly been achieved. You indicate that since most states have dropped restrictions on AMT's, that the protections afforded by the Parity Act are no longer relevant. However, we firmly believe that if the preemption of prepayment penalties ceases to be effective, the volume of AMT's will decline as federally-chartered lenders will cease to face competition from state housing creditors, and will no longer have the drive that competition instills in the market place. Congress' charge to the OTS was not only to promote AMT's, but to promote housing credit generally. If OTS adopts this Proposal, it will be abandoning this charge.

6. We acknowledge that what appears to be the real driver behind the Proposal is the perception that prepayment penalties are an indicia of "predatory lending." Of course, this is not true. The economics of mortgage lending dictates the relationship between a prepayment penalty and the cost of a loan. Prepayment penalties are a means of reducing initial loan costs to the borrower. If prepayment penalties are evil, in and of themselves, then federal thrifts and other federally-chartered institutions should be prohibited from charging prepayment penalties as well.

There are already ample federal and state laws on the books to attack the evils of predatory lending. Stronger enforcement of existing law and regulation is the answer to checking the evil of predatory lending. Eliminating prepayment penalties is not an answer.

SUMMARY

We applaud the work and effort of the OTS in considering whether change in its regulations with respect to state-chartered housing creditors is warranted. Unfortunately, we feel that you have come to the wrong conclusion because you have too narrowly focused on the elimination of restrictions on adjustable rate mortgage lending in most of the states. The purpose of the Parity Act and the mission of the OTS in promulgating regulations to meet that purpose, still must be met. And, that purpose is to make more housing credit available by giving state-chartered housing creditors parity with federally-chartered institutions and eliminate the discriminatory impact of state laws. These fundamental purposes are still to be served. They are well served by leaving in place the existing regulations. The proposed change would negatively affect the balance of parity between federally-chartered and state-chartered housing lenders and would negatively impact the availability of housing credit.

Very truly yours,

Maurice L. Shevin

Maurice L. Shevin
GENERAL COUNSEL

MLS/jsm
c: Jeffrey L. Zeltzer, Executive Director, National Home Equity Mortgage Association

::ODMA\PCDOCS\DOCSBHM\983264\1