NATIONAL ASSOCIATION OF ATTORNEYS GENERAL
750 FIRST STREET NE SUITE 1100
WASHINGTON, D.C. 20002
(202) 326-6016
(202) 408-6998
http://www.naag.org

June 24, 2002

237

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

Re: Docket No. 2002-17

Dear Sir or Madam:

These comments are submitted on behalf of the undersigned Attorneys General, in response to the Office of Thrift Supervision's notice of proposed rulemaking on preemption and the Alternative Mortgage Transaction Parity Act ("Parity Act"), issued on April 25, 2002.

We strongly support the Office of Thrift Supervision's (OTS) proposed amendments to its rules governing the Parity Act. In a letter dated July 5, 2000, 44 Attorneys General, the District of Columbia Corporation Counsel, and the Hawaii Office of Consumer Protection advised OTS that the issue of predatory mortgage lending was a major consumer protection concern of state attorneys general. The Comments noted that OTS had inadvertently contributed to predatory practices by promulgating regulations and issuing opinions that tended to preempt state consumer protection laws relating to non-federally regulated lenders. The Comments also expressed the specific concern that OTS's preemption, under its Parity Act rulemaking authority, of state law restrictions on prepayment penalties and late fees had encouraged abusive practices, particularly on the part of non-federally regulated mortgage lenders.

As OTS has recognized, the mortgage lending marketplace has undergone enormous changes since the Parity Act was enacted in 1982. The early 1980s were a period of unprecedented high interest rates complicated by restrictive state lending laws, including some state laws restricting adjustable rate mortgages (ARMs). The underlying purpose of the Parity Act was to expand available credit to home buyers by encouraging lenders to originate "alternative mortgages"[1] – namely, mortgage loans other than traditional fixed-rate loans. The Parity Act gave state-chartered institutions (depository and non-depository) parity with federal depository institutions to make such mortgages. If a state housing creditor followed the alternative federal scheme, the creditor was allowed to make alternative mortgages, notwithstanding any state laws or regulations prohibiting them.

Now, twenty years later, former state law restrictions on lenders' ability to make ARMs have been almost entirely eliminated. The Parity Act, therefore, serves little useful purpose. Instead of serving to enable adjustable rate mortgage loans, the Act now allows predatory lenders to shield themselves from state consumer protection laws intended to protect homeowners from abusive mortgage lending practices.

In the experience of state attorneys general, predatory lending is largely perpetrated by non-depository lenders and mortgage brokers. As OTS is well aware, these "housing creditors," unlike depository institutions, are subject to essentially no regulation by OTS or other federal agencies. As a result, an increasing number of these lenders purposely structure their mortgage loans – and, in particular, subprime loans – as "alternative mortgage transactions" in order to rely on the preemptive effect of the Parity Act, and to evade state consumer protection laws without any counterbalancing federal regulation.

Under regulations promulgated by OTS, state housing creditors currently are authorized to charge, without limitation, prepayment penalties and late fees in making alternative mortgage loans. *See* 12 C.F.R. §§ 560.34, 560.33. Many states, however, have consumer protection laws expressly prohibiting or restricting prepayment penalties in mortgage loans, and regulating the amount of late fees that may be charged. The restrictions on prepayment penalties, in particular, can be a key component to combating predatory lending.

Prepayment penalties are far more common in subprime loans than in the mainstream mortgage lending marketplace. Among other things, prepayment penalties serve to "lock" consumers into a loan for a period of time, often up to five years, preventing the borrower from

---

[1]Under the Parity Act, an "alternative mortgage transaction" is defined as:

> a loan or credit sale secured by residential real property, a dwelling, . . . or a residential manufactured home. . .
>
> (A) in which the interest rate or finance charge may be adjusted or renegotiated;
> (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 [balloon loans]; or
> (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. . . .

12 U.S.C. § 3802(1).

refinancing with another lender on more beneficial terms. Borrowers thus can be penalized for exercising their right to get out of a high-cost loan.

Moreover, consumers are often unaware that their loan contains a prepayment penalty, and learn of it only when they attempt to refinance. At least in the subprime context, it has been our experience that prepayment penalties are rarely bargained for, and that they do not result in lower interest rates for borrowers. In the previously submitted Comments to OTS, the Attorneys General attached consumer complaint summaries that contained examples of loans cynically devised as "alternative" mortgages without any benefit to the borrower and for the apparent primary purpose of circumventing state law restrictions. In one case, the "variable" rate could fluctuate only between 15.9% and 16.0%. In another case, the first mortgage rate of 14.99% could be reduced by just .25% if the borrower made all payments on time for three years. In both cases, the prepayment penalty exceeded 7% of the loan amount and existed for five years, and would have been prohibited by state law but for OTS regulatory preemption.

As the chief law enforcement officers of our states, we look with disfavor on attempts to preempt state laws designed to protect our citizens, particularly when the federal regulatory scheme offers no similar protections. Accordingly, we commend OTS's proposal to delete §§ 560.34 and 560.33 from regulations relating to the Parity Act. We believe that the proposed amendments will help to limit predatory practices by preventing state housing creditors from structuring loans as alternative mortgages as a means of charging unlimited prepayment penalties and late fees on high cost mortgage loans.

We also agree with OTS's proposed recommendations to Congress, particularly those recommendations that Congress: (1) revisit the Parity Act, because the Act has minimal, if any, continued utility; or (2) permit states another opportunity to opt out of the preemption dictated by the Parity Act. At the time the Parity Act was passed, states were given three years to opt out from the Act's preemption provisions, and a few states did so. However, since that opt-out period, states have witnessed fundamental changes in the mortgage loan market, including an explosion in subprime lending and increased abusive practices. These changes, along with OTS's expansive preemption regulations, were not anticipated by Congress or the states at the time the Parity Act was passed. Therefore, if the Parity Act remains in place, states should be allowed to reconsider whether to opt out from its preemption provisions.

We appreciate this opportunity to express our views on this matter. Please feel free to contact any one of us directly, NAAG Legislative Director Blair Tinkle, at 202-326-6258, or NAAG Consumer Protection Project Director Sarah Reznek, at 202-326-6016.

Sincerely,

Bruce Botelho
Attorney General of Alaska

Janet Napolitano
Attorney General of Arizona

Mark Pryor
Attorney General of Arkansas

Bill Lockyer
Attorney General of California

Ken Salazar
Attorney General of Colorado

Richard Blumenthal
Attorney General of Connecticut

M. Jane Brady
Attorney General of Delaware

Robert R. Rigsby
Corporation Counsel
District of Columbia

Robert A. Butterworth
Attorney General of Florida

Thurbert E. Baker
Attorney General of Georgia

Stephen H. Levins[1]
State of Hawaii
Office of Consumer Protection

Alan G. Lance
Attorney General of Idaho

Jim Ryan
Attorney General of Illinois

Steve Carter
Attorney General of Indiana

Tom Miller
Attorney General of Iowa

Carla J. Stovall
Attorney General of Kansas

A.B. "Ben" Chandler III
Attorney General of Kentucky

G. Steven Rowe
Attorney General of Maine

J. Joseph Curran, Jr.
Attorney General of Maryland

Tom Reilly
Attorney General of Massachusetts

Jennifer Granholm
Attorney General of Michigan

Mike Hatch
Attorney General of Minnesota

Mike Moore
Attorney General of Mississippi

Jeremiah W. Nixon
Attorney General of Missouri

Mike McGrath
Attorney General of Montana

Frankie Sue Del Papa
Attorney General of Nevada

Philip T. McLaughlin
Attorney General of New Hampshire

David Samson
Attorney General of New Jersey

Patricia Madrid
Attorney General of New Mexico

Eliot Spitzer
Attorney General of New York

Roy Cooper
Attorney General of North Carolina

Wayne Stenehjem
Attorney General of North Dakota

Betty D. Montgomery
Attorney General of Ohio

Hardy Myers
Attorney General of Oregon

Mike Fisher

D. Michael Fisher
Attorney General of Pennsylvania

Sheldon Whitehouse
Attorney General of Rhode Island

Charlie Condon
Attorney General of South Carolina

Mark Barnett
Attorney General of South Dakota

Paul Summers
Attorney General of Tennessee

John Cornyn
Attorney General of Texas

Mark Shurtleff
Attorney General of Utah

William H. Sorrell
Attorney General of Vermont

Jerry W. Kilgore

Jerry Kilgore
Attorney General of Virginia

Christine O. Gregoire
Attorney General of Washington

Darrell V. McGraw Jr.
Attorney General of West Virginia

James E. Doyle
Attorney General of Wisconsin

[1]Of the states listed, Hawaii is not represented by its Attorney General. Hawaii is represented by its Office of Consumer Protection, an agency which is not a part of the state Attorney General's Office, but which is statutorily authorized to represent the State of Hawaii in consumer protection actions. For the sake of simplicity, the entire group will be referred to as the "Attorneys General," and such designation as it pertains to Hawaii, refers to the Executive Director of the State of Hawaii Office of Consumer Protection.