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The Market Funded Lending Industry

June 19, 2002

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

Attention Docket No. 2002-17

Ladies and Gentlemen:

The American Financial Services Association ("AFSA") was established in 1916 and is based in Washington, D.C. AFSA is the national trade association for market funded providers of financial services to consumers and small businesses. These providers (over 500 of which are members of AFSA) offer an array of financial services, including unsecured personal loans, automobile loans, home equity loans and credit cards through specialized bank institutions.

This letter is in response to your request for comments in the Notice of Proposed Rulemaking published in the Federal Register on April 25, 2002 (67 FR 20468) (the "NPR"). The NPR announced your intent to revisit, among other things, the OTS regulations on prepayment charges and late charges for state housing creditors. Under the NPR the OTS seeks to remove the authority for state housing creditors to enter into "alternative mortgage transactions" without regard to state law limitations on late charges and prepayment charges.

Congress enacted the Parity Act to increase the amount of private investment capital that flowed into the mortgage loan industry. The new statute eliminated restrictive state laws (through the operation of federal preemption) so that state licensed housing creditors could develop alternative mortgage products that matched the needs of both consumers and Capital markets. Once the needs of Capital markets and consumers match, capital (in the form of mortgage credit) is allocated to local communities at a much more efficient rate. That principle has proven to be successful beyond anyone's expectation. More people, in more communities, have access to mortgage credit than ever before in the history of the world. This is true even in communities where institutions regulated by the OTS do very little lending. The range of mortgage products

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available through state licensed housing creditors, and the ability to modify those products to meet the needs of both Capital markets and consumers, has never been greater. The Parity Act enables a state licensed housing creditor to offer uniform loan products across state lines. This, in turn, lowers the creditor's costs and makes credit more widely available. Because the mortgage loan market is highly competitive, the Parity Act has helped to reduce consumer's cost of borrowing. Thus far, the OTS' judicious exercise of regulatory discretion has successfully accomplished the objectives of the Parity Act and ultimately benefited the consumer.

AFSA is concerned that the proposed rulemaking will undermine all that has been accomplished thus far and will restrict credit.

Prepayment Charges. Prepayment charges permit housing creditors to offer attractive mortgage products at lower rates. In addition, the value of adjustable rate loans, the principal type of "alternative mortgage transaction," depends in large part on prepayment charges. Finally, if prepayment charges are not available, the only alternatives available to state licensed housing creditors will be more costly to consumers and will put state licensed housing creditors at a significant disadvantage. Thus, prepayment charges are valuable loan features for both borrowers and lenders. These three points are explained in more detail below.

The value of a mortgage, in part, depends on the expected period of time that the mortgage loan will be outstanding. If a borrower pays off a mortgage loan in advance of this expected period, the holder of the mortgage loan does not realize the full value expected to be received from the loan. A prepayment charge that's payable by a borrower who pays off a loan earlier than expected helps offset the reduction in value resulting from the early payoff. Capital markets recognize the increased value of a mortgage that contains a prepayment charge and is willing to pay a higher premium for such a mortgage. Consequently, a mortgage lender can offer a lower interest rate and/or lower loan fees on a loan which has a prepayment charge and still obtain from the secondary market the same return as it would on a mortgage with a higher interest rate or higher loan fees that does not provide for a prepayment charge. While some may view prepayment charges as an attempt to "lock in" consumers to a high interest rate mortgage, in actuality, however, prepayment charges are a mechanism to permit responsible housing creditors to offer consumers a lower priced alternative. The elimination of the federal preemption on prepayment charges will deny consumers the opportunity to choose a lower priced loan in many states.

A prepayment charge is an important aspect of "alternative mortgage transactions." Unlike late charges (discussed below), prepayment charges are of particular importance for adjustable rate mortgage loans. With adjustable rate loans, a borrower can ride interest rates down in a falling interest rate environment, but as soon as

rates start to rebound, the consumer can refinance to a lower-rate, fixed-rate loan. While prepayment charges do not prohibit a borrower from playing the market in this manner, they at least ameliorate the negative impact on the holder of the mortgage loan. The OTS has previously recognized the importance of prepayment charges on adjustable rate loans. In a letter dated April 30, 1996, Carolyn J. Buck, the Chief Counsel of the OTS, addressed a Wisconsin statute that prohibited the imposition of prepayment charges if a consumer repaid a loan within 30-days of the receipt of a rate change notice on an adjustable rate mortgage. Ms. Buck, opining that the state law was preempted under the Parity Act, noted:

If state housing creditors were required to follow the Wisconsin Statute when making variable-rate mortgage loans, they would clearly be disadvantaged vis-a-vis federal thrifts -- the very result Congress intended to prevent. The Wisconsin Statute thus appears to fall within the scope of laws preempted by the Parity Act. Accordingly, state savings associations and state housing creditors that are not state banks or credit unions and that originate variable-rate loans in conformity with all applicable OTS regulations need not comply with the Wisconsin Statute. (1996 OTS LEXIS 19 at page 8)

We note that this letter was prepared contemporaneously with the OTS rules that clarified that state chartered savings associations and state licensed housing creditors utilizing the Parity Act could rely upon the authority available to federal savings associations to include prepayment provisions in their alternative mortgage loans. The OTS has previously recognized the specific competitive value prepayment charges offer state licensed housing creditors, and it should not now withdraw that authority.

It was suggested in the NPR that the impact of eliminating the federal preemption applicable to prepayment charges can be "ameliorated somewhat" by imposing a "higher overall interest rate" or requiring the payment of points upon origination. 67 F.R. 20468, 20473. This suggestion is particularly disturbing. The proposed alternatives would be more costly to consumers and illustrate the reason why the current rule should be retained -- the need for parity among competing lenders. Higher rates or more loan fees are not a satisfactory alternative for most consumers. Most consumers do not repay their mortgage loans within the relatively brief period in which prepayment charges are in effect.¹ Those that do not repay their mortgage loans early are not effected by the prepayment charges. However, higher interest rates and higher points -- the suggestion contained in the NPR -- would apply to all consumers, whether they prepaid their mortgage loans during the first

¹ While prepayment charge formulations vary considerable, most prepayment provisions terminate within three to five years after closing. In addition, almost all prepayment charge formulas provide that the amount of the charge decreases during its relatively short effective term.

publications and in the same media as federally chartered lenders. State licensed housing creditors will be at a distinct competitive disadvantage if they must advertise higher interest rates and higher points than their federally chartered competitors. To quote the former OTS Chief Counsel, "they would clearly be disadvantaged vis-a-vis federal thrifts -- the very result Congress intended to prevent."

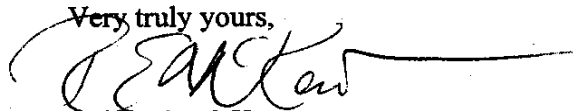
Creditor Differentiation. The NPR specifically asked whether the OTS has the authority under the Parity Act to differentiate between state housing creditors that are depository institutions and other types of state licensed housing creditors. The Parity Act seeks to "prevent discrimination against State-chartered depository institutions, and other nonfederally chartered housing creditors".² The Parity Act makes no distinction among state chartered savings associations and state licensed housing creditors, the two types of entities that look to the OTS for guidance under the Parity Act. Both are to be protected under the Parity Act. The OTS has no authority to differentiate between them and to do so would further limit the intended protections and further undermine the purpose of the Parity Act.

Late Charges. With respect to late charges, we concede the preemption of state limitations serves a limited purpose under the Parity Act. Late charges are not unique to "alternative mortgage transactions" and do not provide any unique benefit when used with an "alternative mortgage transaction" as compared with a fixed-rate, fully amortizing mortgage. We have no objection if the OTS rescinds the authority of housing creditors to rely on the Parity Act to assess late charges as provided under the regulations applicable to federal savings associations.

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We hope this letter has been helpful to you. If you have any additional questions or comments, do not hesitate to contact us.

Very truly yours,



Robert E. McKew

Senior Vice President and General Counsel

HC#35144

² 12 U.S.C. 3803 (a)