ACORN

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June 24, 2002

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

RE: Docket No. 2002-17, the Alternative Mortgage Transaction Parity Act, Preemption

Dear Madam/Sir:

On behalf of ACORN's 120,000 member families, I write to support the OTS's proposed rule revising its interpretation of AMTPA and to strongly urge the OTS to follow through with a final rule that restores the states' authority to regulate prepayment penalties and late fees on alternative loans made by state-chartered housing creditors. The issuance of such a final rule would be a significant step forward in allowing states to establish basic consumer protections against some of the key predatory lending abuses.

This issue is especially significant in light of the tremendous increase in the share of the national mortgage market made by state-chartered housing creditors. Two or three decades ago, federally-insured institutions originated around 80% of mortgages while state housing creditors originated the remaining 20%. Today, those proportions are reversed, with state housing creditors now originating around 80% of home loans each year.

As you know, unlike federally-insured institutions, state-chartered housing creditors are not subject to any type of regular, ongoing monitoring or supervision of their lending practices by any federal agency. Yet because of a 1996 change in the interpretation of AMTPA – a change made without any legal justification or even any public comment process – these state-chartered housing creditors are now able to easily sidestep any state law consumer protections on prepayment penalties or late fees by structuring the loan as an alternative mortgage (defined as a loan that contains an adjustable rate or a balloon payment, or that negatively amortizes). This interpretation has provided the legal avenue for many unscrupulous state-chartered creditors to strip thousands of dollars of

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individual borrower's hard-earned home equity, to lock homeowners in at interest rates well above what is appropriate for their credit risk, and to trap families in a downward spiral of excessive late charges from which they can never escape.

For state-chartered housing creditors, the only regular monitoring occurs at the state level when they initially apply for a state license to originate home loans and then subsequently apply to renew that license. While this approval process is typically a rubber stamp and rarely if ever involves any real examination of how the lender conducts its business, it remains the only occasion when state housing creditors have even the potential to be supervised in even the most rudimentary way. As state housing creditors are licensed at the state level and any abusive (although possibly not illegal) lending practices engaged in by state housing creditors are more likely to be investigated at the state level, it is only appropriate that state housing creditors should also be subject to state laws regarding consumer protections on home loans.

In examining the financial damage inflicted to consumers by abusive prepayment penalties that would otherwise be prohibited under state law in many states, it is critical to keep in mind how prepayment penalties function differently in the prime and subprime markets. In the prime market, the 1% to 2% of loans that contain prepayment penalties provide an explicit reduction on standardized interest rates. By comparison, on the three-quarters or more of subprime loans that contain prepayment penalties, the situation is greatly complicated by the fact that interest rates on subprime loans are not standardized, and it is extremely difficult to shop for the best loan in the subprime market. The vast majority applicants on subprime loans are never offered one rate without a prepayment penalty and another, slightly lower rate with such a penalty. And for predatory lenders, they are even easier to hide in the stack of paperwork than up-front fees. Most of the time, the borrower is either completely unaware that the penalty exists or does not understand what its impact will be.

In the subprime market, a prepayment penalty becomes simply another means to generate profit for the lender without providing any benefit to the borrower. In most cases, the practical effect of prepayment penalties is to add another layer of fees to their loans since over half of subprime loans with these penalties are paid off before the penalties have expired, usually within the first three to five years of the loan. The penalties typically cost consumers thousands and thousands of dollars – often up to 5% or even 7% of the loan amount. Between high financed fees and prepayment penalties, lenders who want to take advantage of a trusting or vulnerable borrower can essentially walk away with 15% of the total loan amount – not even considering interest charges – for putting someone in an extremely high rate loan, even if by all rights they should have qualified for a much lower 'A' rate. The huge profits that can be gained from such equity stripping provide a significant financial incentive for unscrupulous lenders to engage in high-pressure sales tactics simply to generate high loan volume, regardless of the ultimate effects on an individual consumer's financial situation, or even the ability of the borrower to repay and the loan to perform over time.

A classic example of how this situation regularly plays out involves Maria and Manuel R from New Jersey. They had bought their home in 1999 with an interest rate around 7% and have excellent credit, with FICO and other credit scores of over 700. After receiving a number of phone soliciations from a lender in the summer of 2000, they became interested in paying off some credit cards but did not want to refinance their mortgage. When they went in to the lender's office, the loan officer convinced them not to worry and told them that everything would be taken care of. They were not told that the $119,800 mortgage they were given increased their interest rate to 10.3%, financed in nearly $10,000 in fees, contained a balloon payment of $99,805 after 15 years (thus qualifying as an alternative mortgage), and – most relevant to the issues at hand – contained a five-year prepayment penalty for six months' interest on the amount prepaid in excess of 20% of the original loan amount. Maria and Manuel are currently in the process of refinancing to a more reasonable interest rate, but the prepayment penalty means that they will lose another $6,000 of their hard-earned equity – on top of the original $10,000 in fees financed into their loan. Such a prepayment penalty would not be allowed under New Jersey law if the loan had not been structured as an alternative mortgage and therefore subject to AMTPA preemption.

But even if prepayment penalties never end up being assessed, they can inflict severe costs by trapping borrowers in mortgages with interest rates above what is appropriate for their risk by preventing them financially from refinancing. Usually, this occurs because the penalty pushes a borrower's loan-to-value ratio above the limit set by a competing lender that is offering a lower rate. In other cases, borrowers back out from refinancing to a lower rate when they realize the cost that would be imposed by the penalty. Regardless of whether the cost of the penalty is paid directly or indirectly, prepayment penalties regularly result in borrowers paying thousands and thousands of dollars more than they would in a properly functioning market where borrowers with excessive rates would be able to refinance at more reasonable rates. Given the tremendous damage inflicted by abusive prepayment penalties, consumer protections on prepayment penalties should not be preempted at the federal level.

We would also point out to the OTS how frequently lenders structure loans intentionally to get around AMTPA, making the loans adjustable in name only. Some lenders – most notably Household Finance and Beneficial, following a practice of Associates First Capital (which is still under indictment by the FTC for deceptive and abusive lending practices) – structure loans to reduce the interest rate by small amounts for no late payments in order to qualify as alternative loans. While this laudable idea often plays out much differently in practice than would be expected (e.g., a borrower with good credit has no late payments over five years on a 14.0% interest first mortgage and qualifies for a "reduced" rate of 13.2%), the existence of such a provision should not affect whether the loan is subject to state consumer protection laws regarding prepayment penalties and late charges. Lenders should be free to offer such rate programs, but it does not make any sense to allow a loan with such a provision to contain a five-year prepayment penalty for six months' interest while state law, for example, might potentially prevent a fixed high-

rate loan from having a prepayment penalty longer than two years or higher than 2% of the loan amount.

While the primary public focus of the AMTPA debate has centered around its impact on prepayment penalties because of their prevalence and substantial financial consequences, we have also started to see a growing number of abuses around the imposition of excessive late fees. In many cases, alternative loans regularly call for late fees of 10% of the monthly payment amount. As high interest rates can lead to monthly payments of $2,000 or higher even on modest homes, the potential to charge a late fee for over $200 can easily lead to lenders unfairly charging huge fees. We have heard a number of horror stories from borrowers who have had payments that were made on time counted as being late. In such cases, the costs spiral upwards, and borrowers who are typically unclear about their legal rights and unable to find and/or afford a lawyer quickly find themselves in an exceedingly difficult position. Within a short time, they can end up facing an effective choice between paying substantial late fees or potentially losing their house. Since late fees are standard on any loan – adjustable or non-adjustable – there is no policy rationale for federal preemption to come into play for one of those two classes of loans.

In the trade press, some industry lobbyists have claimed that the OTS's proposal to close the AMTPA loophole could limit consumer choice. But it is implausible to argue that borrowers in subprime loans "choose" prepayment penalties nearly 80% of the time while prime borrowers do so only 2% of the time. It becomes even more implausible when describing a market that is not by any stretch of the imagination driven by interest rate price competition (if it were price-driven, how could from 30-50 percent of borrowers in subprime loans actually qualify for much lower prime rates?). The evidence is clear to us that prepayment penalties do tremendous harm and often severely limit consumer choice by trapping consumers in high-rate loans. At the very least, states should be allowed to make their own decisions with regard to this question.

Some in the industry also argue that predatory lenders do not follow the law anyway and would not be deterred by state consumer protection laws anyway. While we agree that predatory lenders regularly transgress laws against deceptive lending practices, one of the problems with those laws is that they require a substantial amount of resources to enforce because of the tremendously challenging task of documenting fraudulent and deceptive practices. In contrast, most state laws regarding prepayment penalties and late fees set out straight-forward guidelines for lenders on what types of provisions are prohibited on home loans. Even the worst predatory lender will be loathe to violate a state law that clearly describes what types of terms are prohibited. And if a lender does break the law, it should be a simple matter of enforcement either by the appropriate government prosecutor or through a private right of action, in contrast to the complicated legal hurdle of proving fraud or deception.

Finally, we would urge the OTS to follow through on asking Congress to reevaluate the purpose of AMTPA with an eye towards repeal. The law's purpose has already been met with the repeal of state laws prohibiting adjustable mortgages. It should no longer serve as a loophole around state consumer protection laws.

Thank you for your consideration. If you have any questions regarding ACORN's comments, please contact Chris Saffert in our Washington office at (202) 547-2500.

Sincerely,

Maude Hurd
National President, ACORN