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By Facsimile and Mail

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

Re: Docket # 2002-17, Notice of Proposed Rulemaking (Alternative Mortgage Transaction Parity Act; Preemption)

Dear Sir/Madam:

We appreciate the opportunity to comment on the Office of Thrift Supervision's ("OTS") notice of proposed rulemaking ("NPR") regarding the Alternative Mortgage Transaction Parity Act ("AMTPA" or "Parity Act"). This comment letter is submitted on behalf of certain of our clients who are state-licensed lenders that make "alternative mortgage loans" and are "housing creditors" for purposes of the AMTPA.

Summary. The NPR proposes to revise the OTS's Parity Act rule, 12 C.F.R. § 560.220, by deleting the rule's identification of certain other OTS regulations (on prepayment and late charges) as applicable to state housing creditors making alternative mortgage loans under the Parity Act. According to the NPR, the OTS intends by this change effectively to remove the preemptive effect of the Act in these areas and thereby return the regulation of prepayment and late charges on such alternative loans by housing creditors to the various states.

In brief, we urge the OTS to reconsider this proposed change to the AMTPA rule. The proposal is based on a highly uncertain interpretation of the Parity Act, a view that may well not survive the litigation that will likely ensue if the change is consummated as proposed. Because of this uncertainty and for other reasons explained below, it is quite likely that the proposed change would not accomplish the OTS's goals and could well have unintended effects contrary to those goals. If the OTS believes that some action in this area is required to control the abusive use of prepayment penalties and late fees by housing creditors, there is a far more appropriate route: revise the OTS's prepayment and late charge rules to directly control such abuse and apply those revised rules to all housing creditors under the Act, including those supervised by the

OTS. This solution is both much more likely to achieve the OTS's goals and it has been recommended by the bulk of commenters on the rulemaking, across the spectrum from consumer to industry groups.

1. The Shaky Premise of the Proposal

The Proposal's Premise. The proposed rule is based on the notion that the Parity Act provides the OTS with statutory authority to choose which subject areas of state lending law (that would, in the absence of the Act, regulate an alternative mortgage loan provided by a housing creditor) are preempted by the Act and which are not. At least, the proposal claims for OTS the authority to remove from the preemptive coverage of the Act areas (such as prepayment penalties and late fees) that the OTS deems to be "not intrinsic to" or "essential to,"[1] alternative mortgages. The result would be to leave regulation of such areas up to state law.

This "intrinsic to" or "essential to" test has no basis whatsoever in the language of the Parity Act. It is by no means clear that the Act can be read to provide the OTS with this authority to expand or contract the Act's preemptive effect. In fact, the most natural reading of the Act, based on its text, structure, and purpose, is to the contrary.

The Parity Act. The text and structure of the Parity Act are clear and the operation of its preemption is straightforward. First, the Act defines a class of "alternative mortgage transactions," which the Act covers. 12 U.S.C. § 3802. Then the Act provides that so long as a state housing creditor complies with applicable *federal* regulations governing such alternative mortgage transactions, 12 U.S.C. § 3803(a), the housing creditor may make alternative loans notwithstanding "any" contrary State law:

> An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.

12 U.S.C. § 3803(c). The qualifier "in accordance with this section" simply ensures that the housing creditor only gets the benefit of AMTPA preemption if the creditor makes the loan "in accordance with regulations governing alternative mortgage transactions as issued by the Director of the [OTS]." 12 U.S.C. § 3803(a)(3).[2] Thus, once a loan qualifies as an "alternative" mortgage, and so long as the housing creditor making such a mortgage complies with the federal regulations governing such loans, the housing creditor effectively gains the same power as a federal thrift in making the same loan and may do so "notwithstanding any" provision of State law to the contrary.

Nowhere do these key preemption or definitional provisions of the Act authorize the federal banking agencies to scale back on the scope of the Act's preemptive effect. As quoted

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1 67 Fed. Reg. 20468, 20470 (April 25, 2002).

2 Actually, the statute only requires "substantial compliance" with the federal regulations, or correction of any error within 60 days. 12 U.S.C. § 3803(b).

above, the Act's preemption is absolute and applies "notwithstanding any" State law. If the federal banking agencies were able to re-impose on the state housing creditors select provisions of State law, such a view would be contrary to the fundamental purpose of the Act, which Congress intended to

> eliminate the discriminatory impact that [federal] regulations [authorizing alternative mortgage transactions] have upon nonfederally 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 U.S.C. § 3801(b). The federal banking agencies may of course impose alternative mortgage regulations on housing creditors that are every bit as restrictive as those of the States, but not in a way that has a "discriminatory impact" on State housing creditors. The banking agencies may only do so by imposing such regulations generally, on both the State creditors *and* the agencies' *federally* regulated lenders as well. Thus, the Act provides actual "parity."

Section 807(b). The contrary view that the Act authorizes the banking agencies to re-impose on housing creditors select provisions of the various State laws appears to be based entirely on section 807(b) of the larger public law (of which the Parity Act was one title), the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. 97-320, 96 Stat. 1469 (1982). Section 807(b) was an uncodified section of this public law. Read in context, this provision plainly was not designed to carve back on the broad preemption provided elsewhere by the Act. It is important to read this section in its entirety:

> Within sixty days of the enactment of this title [Oct. 15, 1982], the Comptroller of the Currency, the National Credit Union Administration, and the Federal Home Loan Bank Board shall identify, describe, and publish those portions or provisions of their respective regulations that are inappropriate for (and thus inapplicable to) or that need to be conformed for the use of, the nonfederally chartered housing creditors to which their respective regulations apply, including without limitation, making necessary changes in terminology to conform the regulatory and disclosure provisions to those more typically associated with various types of transactions including credit sales.

Pub. L. 97-320 § 807(b). By its terms, this section contains *no* grant of authority to the federal banking agencies to decide which state laws are preempted by the Act. Rather, this section only authorizes the federal agencies to determine which sections of their own regulations are "inappropriate" to be applied to a housing creditor. Thus, this section appears to be designed to give the agencies 60 days to review their regulations and weed out those rules that cannot sensibly be applied to state-chartered housing creditors or that "need to be conformed," including "necessary changes in terminology," so that they can be appropriately applied to all housing creditors.

This view is also confirmed by the structure of section 807(b). This provision was not contained in those substantive parts of the Act that specify the key definitions or authorize preemption. Instead this provision was part of the final section of the Parity Act title, the uncodified housekeeping section of the Act. (For example, the other half of this section, 807(a), provides for the effective date of the Parity Act.) Moreover, the sixty day limit is inconsistent with the notion that Congress intended this provision to be one under which the banking agencies would be making such important policy decisions regarding which parts of State law are (or are not) preempted by the Act. The brief sixty day timeline appears instead to be gauged as sufficient time to read through an agency's regulations to find (and if possible conform or make any terminology changes) to those provisions that simply do not fit the state-chartered housing creditors or their business.

To say this was to be principally a housekeeping exercise is not to say it was trivial. Only after the banking agencies identified and/or conformed their relevant regulations so that they could be applied to state-licensed lenders could such a lender know exactly how to comply with the federal regulations to ensure its alternative loans would be outside the scope of otherwise applicable State laws.

This view is also consistent with the leading judicial opinion interpreting the Parity Act. National Home Equity Mortg. Ass'n v. Face, 239 F.3d 633 (4th Cir.), cert denied 122 S.Ct. 58 (2001). In the words of the Fourth Circuit:

> Section 807(b) is not a provision that defines the scope of federal preemption. Rather, it defines the gate through which the non-federally chartered housing creditors must pass in order to obtain the benefits of the Parity Act. If a state lender conforms to the regulations listed in the regulation implementing § 807(b), then it will enjoy the preemptive protection that the Act grants in 12 U.S.C. § 3803(c).

239 F.3d at 640 (emphasis added). The Parity Act "gate" imposes identical restrictions on all housing creditors, whether federally- or state-chartered. The current proposed rulemaking violates this reading of the statute's language.

The 1996 OTS Interpretive Letter. This reading is also consistent with the view espoused by OTS staff prior to the 1996 change in the OTS's AMTPA regulation which clarified that OTS regulations on prepayment penalties and late fees applied to housing creditors making alternative mortgages. Contrary to assertions that some commenters have made, the contemporaneous evidence shows that the OTS's action in late 1996 to identify its prepayment regulations as applicable to housing creditors was *not* a change that "expanded" the preemptive effect of the Act. As explained above, the preemptive effect of the Act cannot be expanded or contracted by OTS regulation.

Even before the OTS's AMTPA rule was changed to identify the OTS prepayment rule as applicable to housing creditors, the OTS issued an Interpretive Letter concluding that the Parity Act preempted a State regulation of prepayment penalties. OTS Interpretive Letter from Carolyn

Buck (April 30, 1996). As the Letter noted, "[i]f state housing creditors were required to follow the Wisconsin [prepayment] Statute when making [alternative] mortgage loans, they would clearly be disadvantaged vis-à-vis federal thrifts – the very result Congress intended to prevent." Id at 5. Moreover, this contemporaneous Interpretive Letter also explained that the then-pending proposed rule to identify the OTS's prepayment rule as applicable to housing creditors was "*not* a substantive change" – *i.e.* it was not an OTS "expansion" of the Act's preemptive effect – "but is being proposed to eliminate possible confusion." Id. at n.12 (emphasis added).

Implications. The 1996 Interpretive Letter appears to make clear that the OTS's recent proposal represents a substantial break from the prior understanding regarding the preemptive effect of the Parity Act. Uncertainty may well now ensue (with litigation sure to follow) from this change. Because the Act (not the OTS's regulation) defines the scope of Parity Act preemption, it is not at all clear what a court would determine to result from an OTS action to delete, from its AMTPA rule, the specific references to OTS prepayment and late charge rules as applicable to housing creditors. It may well be concluded that deleting the identification of OTS prepayment and late charge rules simply removes those rules from the restrictions, "the gate" that housing creditors must pass in order to gain the Act's preemptive effect and be able to make alternative mortgages free from state law.

2. A Better Alternative

The uncertainties highlighted above cast significant doubt on whether the OTS's proposed change can be implemented successfully or whether such a change could lead to increased uncertainty and potential litigation.[3] Moreover, even if that change can be successfully managed, it is difficult to see how it will adequately serve either the purposes of the Parity Act or the control of abusive lending practices.

The proposal would not serve the purposes of the Parity Act. As discussed above, Congress enacted the Parity Act based on the finding that alternative mortgage transactions are essential to an adequate supply of housing finance and that therefore state-licensed lenders must have the same ability to provide such alternative mortgages as do federally-chartered lenders. The principal effect of this level playing field is to allow state housing creditors operating nationwide to make alternative mortgages on the same terms as federally-chartered lenders, and thus to benefit from a single uniform set of regulations.

A patchwork of 51 different State laws (and the resulting compliance costs) may make it impossible for a state-licensed lender to offer competitively priced alternative mortgage loans, leaving this market to federal lenders and state commercial banks (who are clearly permitted to charge prepayment fees under the OCC's AMTPA regulation, 12 C.F.R. § 34.24). The likely

[3] Because the OCC and the NCUA have the same authority to interpret the Parity Act as the OTS, it is also far from clear that the OTS would receive Chevron deference in its interpretation of the scope of the Act's preemption. See, e.g., Proffitt v. F.D.I.C., 200 F.3d 855, 863 n.7 (D.C. Cir. 2000) (refusing to accord Chevron deference to the F.D.I.C.'s interpretation of section 8(e) of the Federal Deposit Insurance Act because the meaning of that section can be interpreted "by more than one agency, namely, the FDIC, the OCC, the Federal Reserve Board and the Office of Thrift Supervision."); O.T.S. v. Wachtel 982 F.3d 581, 585 (D.C. Cir. 1993) (similarly refusing to defer to the OTS's construction of section 8(b) of the Act).

result would be reduced competition in the provision of alternative loans which could *increase* other lenders' ability to use prepayment penalties and late fees in an abusive manner.

The proposal also would likely fail to achieve the OTS's goal to control abusive lending. The practices identified in the proposed rulemaking -- prepayment penalties and late charges -- are not inherently predatory and can benefit consumers. Beyond the fact that the responsible use of such fees can reduce the overall costs of consumer credit and provide safety and soundness benefits to lenders, such fees can also make it *more* difficult for lenders to engage in other identified predatory practices. Prepayment penalties, for example, may make loan "flipping" more difficult to accomplish. Late charges can properly allocate the costs of delinquency on the delinquent party, rather than forcing a lender to spread these costs across all its borrowers.

If the OTS believes that some action must be taken to control abusive use of prepayment penalties and late fees, the appropriate course is to deal with those objectionable features directly, by working with industry and consumer groups to craft rules defining the bounds of permissible conduct. A wide variety of comments on both the current and the advance NPR suggest that this approach -- more so than the NPR's proposed change to the AMTPA rule -- is favored by the wide spectrum of interested parties. In fact, many "best practices" have already been developed by a variety of organizations and industry groups.

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We appreciate this opportunity to comment on the AMTPA Notice of Proposed Rulemaking. Although we are skeptical that the proposed change to the AMTPA rule is the appropriate course, we commend the OTS's goals and agree that action should be taken to control abusive lending practices. We urge the OTS to consider a different route to achieve these important goals. If you have any questions or would like to discuss our comments, please do not hesitate to contact the undersigned at (202) 663-6285, or David A. Luigs at (202) 663-6451.

Sincerely,

Ronald J. Greene by DAL

Ronald J. Greene