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Carolyn J. Buck, Esq.
Chief Counsel
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

Re: Effective Date of Amendment to 12 C.F.R. § 560.220

Dear Ms. Buck:

We are writing on behalf of our client, the National Home Equity Mortgage Association, to urge the Office of Thrift Supervision ("OTS") to stay for at least six months the effective date of its regulation amending Section 560.220 (the "Amended Regulation"). We are seeking this stay to provide retail mortgage lenders, wholesale mortgage purchasers, servicers and subservicers and others in the mortgage market adequate time to address issues they face in implementing changes relating to prepayment fees and late charges that arise from the Amended Regulation. Lenders encountering these problems are primarily state-chartered housing creditors that, when entering into alternative mortgage transactions ("AMTs"), rely on the federal preemption afforded by the Alternative Mortgage Transaction Parity Act (the "Parity Act") and applicable OTS regulations. We have been advised that secondary market investors and servicers, including federal savings associations, who purchase or service AMTs are encountering similar problems.

To assist the OTS to prepare for a meeting with us to discuss these and other issues, we will summarize in this letter some of the more significant implementation problems lenders, investors and servicers are experiencing. Please note we are not trying to reopen the substantive issue regarding the wisdom of the rule. We merely are focusing on the timing of its implementation. We believe these problems fall into three basic categories: (1) determining applicable legal requirements; (2) programming systems and revising loan documents issues; and (3) structuring securitizations and pricing loans. Below we briefly describe what we believe are some of the most significant problems being encountered by lenders, investors and servicers.

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Determining Applicable Legal Requirements

Lenders, purchasers and servicers of AMTs have not had to grapple with the patchwork of conflicting state laws on prepayment fees and late fees. Federal preemption has afforded the mortgage lending industry the ability to rely on a uniform national approach to this issue. The Amended Regulation changes that approach.

Now, the mortgage industry is scurrying to try to determine definitively and quickly with which state laws relating to prepayment fees and late charges they will be required to comply. To make this determination requires an in-depth review of the complex and extremely diverse laws and regulations on prepayment fees and late charges in each of the fifty states and the District of Columbia. Many of these laws and regulations: (a) impose special disclosure requirements; (b) limit the period during which the fees may be assessed; and (c) either limit the amount of the fees or prohibit the fees absolutely. Because state-chartered housing creditors traditionally have relied on the Parity Act and OTS implementing regulations when making AMTs to avoid state limitations, very few of these creditors have a firm grasp of this information on a multi-state basis.

There is no single primary source that can readily and quickly supply creditors, purchasers and servicers with the required information as it applies to their respective operations. Unfortunately, this is not the simple exercise of looking at restrictions applicable to fixed-rate products. Many states impose disclosure requirements and limitations on AMTs that do not apply to traditional fixed-rate products. Also, the requirements and limitations applicable to prepayment fees and late charges vary in a number of states according to the interest rate charged on the loan. In short, different licensing frameworks and financing terms may result in the application of a variety of prepayment fee and late charge laws and regulations in a state.

The difficulties outlined above become exponentially greater for investors and servicers (including federal thrifts) that purchase mortgage loans from or service mortgage loans for a multitude of different species of state-chartered housing creditors. For an investor to ensure that the loans it purchases comply with applicable state law, the investor must first determine the prepayment fee and late charge restrictions applicable to each of the various types of entities from which it purchases AMTs. As noted above, the requirements under a state's law that apply to one housing creditor might not apply to others that are licensed under a different law, or that offer loans above specified interest rates. And many housing creditors may have the ability to avail themselves of preemptions under federal laws and regulations other than the OTS Parity Act regulations. For example, some lenders making AMTs might be able to use the following federal laws and regulations to preempt state laws on prepayment fees and late charges: (a) OTS regulations applicable to loans made by federal thrifts or their

operating subsidiaries; (b) OCC regulations applicable to national banks and their operating subsidiaries for certain adjustable rate mortgage loans; (c) OCC regulations applicable to state-chartered commercial banks for certain adjustable rate mortgage loans made pursuant to the Parity Act and applicable OCC regulations; (d) state super parity provisions; and (e) the most favored lender rights granted to different types of depository institutions. Investors are finding it a Herculean task to wind their way through this maze of state laws and regulations. It is equally, if not more difficult, for the servicer who has to ensure the lawfulness of the fees it actually imposes on consumers in accordance with the terms of the loan documents.

Programming Systems and Revising Loan Documents

Technology has revolutionized the modern U.S. mortgage market. It is a systems-driven business, with software and data bases in many cases replacing people to perform origination and servicing tasks. As noted above, figuring out the applicable legal requirements is the first challenge under the Amended Regulation. Once the applicable laws are determined, the next big task is to program the systems and amend the loan documents to reflect the applicable laws. This takes time.

Compliance with the complex and extremely diverse laws and regulations on prepayment fees and late charges of all fifty states and the District of Columbia will require substantial modifications to the computer systems and documents currently in use in the national mortgage market. We have been informed that the mortgage market, including the many software vendors whose loan origination systems are used by lenders, will need more than three months to implement the changes required to ensure compliance with the Amended Regulation. These modifications, however, cannot be started until the legal requirements are determined. Below we have listed what we believe are some of the more significant systems and documentation changes necessitated by the Amended Regulation.

- *Rewriting the AMT promissory notes and loan agreements.* This includes changes in the verbiage describing the timing and amount of fees that may be assessed, and the related disclosures.

- *Preparing and programming newly required disclosures.* This includes disclosures lenders will be required to deliver at or prior to the origination of the loan, as well as those required during the servicing of a loan, that lenders were not required to provide under the regulations in effect prior to the Amended Regulations.

- *Performing modifications to front end loan origination systems.* Loan origination systems must be reprogrammed to reflect accurately state prepayment fee and late charge requirements and limitations. Loan origination systems must also be reprogrammed to include codes that lenders and third parties who provide services to the lenders can use to determine the appropriate prepayment fees and late charges to be applied in a particular state and to each loan product in that state. This may require manual "workarounds," increasing the likelihood of error.

- *Performing modifications to servicing systems.* Servicers, like investors, face several different restrictions that could apply to loans they service, depending on the entity that originated the loan and whether that entity relied on other federal laws or regulations to preempt state prepayment and fee late charge limits. Because loans originated prior to the loss of parity will still remain in servicers' systems, and cannot be segregated from the new non-parity loans, the prepayment penalty calculators that servicing systems use will potentially need to process many different calculations for each state and each loan product. We understand that this requires significant programming efforts.

- *Developing audit and quality control programs.* Originators, servicers and investors must all develop new tools to audit the information in their systems to determine if any of the data regarding prepayment fees and late charges are inaccurate.

- *Training, Operating and Sales Staff.* Changes in the requirements for loans do not occur in a vacuum. Companies need to train their staff on the new changes, and this cannot occur until the required changes are identified and the systems are modified.

While technology may speed the time within which a mortgage may be made, adapting technology to new legal requirements is a labor intensive task.

Structuring Securitizations and Loan Pricing

Mortgage loan pricing is directly related to the pricing of the securities in the capital markets that are based on and backed by mortgage loans. An inherent component to the structure of any mortgage loan securitization is an estimate of prepayment speeds. For the last several years, the capital markets made such assumptions based on the knowledge that the early cash flows payable on the typical subprime mortgage backed

security were higher than they otherwise likely would have been if the underlying loans had contained prepayment fees. In securitizations, prepayment assumptions affect the level of collateralization to generate sufficient cash flows, the number and type of tranches to appeal to the "appetite" of different institutional investors and ultimately the price of the related securities. This task is complicated by issues of commingling loans in pools with and without prepayment fees.

We know that the lack of prepayment fees, with the expected increase in prepayments, will result in an increase in the required yields on subprime mortgage securities and higher prices on mortgage loans; the question is by how much. Over time, the capital markets will adjust as they are able to model prepayment speeds in the subprime sector without prepayment limitations. In the short run, however, investors have yet to quantify the appropriate pricing differentials. The value attributed to similar prepayment fees for fixed-rate loans or "prime" AMTs has limited utility and may not be predictive of the behavior of consumers under subprime AMTs. Absent the ability to model based on historic performance, we believe the natural tendency will be to err of the side of caution by requiring higher yields and collateralization levels and therefore higher loan prices. Lenders and investors need more than three months to determine the appropriate structures for securitizations of what is essentially a new loan product that will include lower or no prepayment fees.

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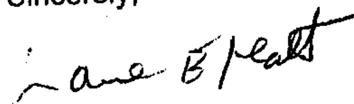
We appreciate your courtesy and attention to this matter. We look forward to meeting with you to discuss these and other issues related to the Amended Regulation in greater detail. In the interim, please do not hesitate to call if you have any questions.

Sincerely,



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cc: Jeffrey Zeltzer
Maury Shevin, Esq.