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Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

ATTN: Docket No. 2000-34

Ladies and Gentlemen:

Saxon Mortgage, Inc. ("Saxon) appreciates this opportunity to comment in response to the advance notice of proposed rulemaking ("ANPR") published April 5, 2000 relating to the mortgage lending regulations of the Office of Thrift Supervision ("OTS") implementing the Alternative Mortgage Transactions Parity Act (the "Parity Act"). Saxon's comments below focus on:

- Saxon's process for determining interest rates for its loans;
- The applicable economic and market environment;
- The function of prepayment penalties in Saxon's loan pricing; and
- Answering certain other specific questions raised in the ANPR.

About Saxon. Saxon is a nondepository housing creditor licensed, complying with applicable licensing exemptions, or otherwise authorized to lend in 49 of the United States and the District of Columbia. In addition to its own loan originations, Saxon acquires residential mortgage loans and home equity loans through brokers and correspondents. Saxon securitizes these loans, and since 1994 has provided funding for over $8 billion of single-family housing finance. Saxon is a "subprime" lender- i.e., most of its loans are made to persons who, because of their financial situations or credit histories, would be rejected by traditional lending institutions subscribing to the lending restrictions ("GSE Guidelines") imposed by Fannie Mae and Freddie Mac pursuant to their charters. Saxon is not a "predatory lender" - i.e, it aggressively guards against the incursion into its loans of any abusive lending practices, such as excessive origination fees, making loans without due regard for the borrower's ability to repay, making loans that provide no tangible net benefit to the borrower, or any other unconscionable origination or foreclosure practices.

Saxon's interest rates. Rates charged by subprime housing creditors such as Saxon tend to be higher than rates ("GSE Rates") charged on loans conforming to the requirements of Fannie Mae and Freddie Mac (the "GSE's") as a result of three factors: (1) higher risk of loss; (2) higher costs to originate, underwrite, and service sub-prime loans; and (3) more costly and volatile sources of funds compared to those of a GSE.

Higher risk of loss. Borrowers whose loans conform to GSE Guidelines ("Prime Borrowers"), by definition, have a virtually flawless record of timely payments to their creditors. As a result, Prime Borrowers' loan payment performance can be predicted relatively accurately. However, sub-prime borrowers, by definition, have a history of missed or late payments on credit cards, installment loans, and mortgages. Under generally accepted principles of credit analysis, past credit problems are a significant indicator of future delinquencies. Typically, delinquency rates for sub-prime loans range from 10%-25%.

Higher delinquencies result in a higher rate of foreclosure than is experienced among Prime Borrowers. Saxon expends considerable resources attempting to cure delinquent loans without foreclosure, because the foreclosure/sale process results in a loss—typically between 20-50% of the original loan amount. Both delinquency and foreclosure represent a loss of interest income to an originator, as well as the subprime servicer, who must advance funds to the note holder to cover delinquent payments.

Higher costs to originate, underwrite, and service subprime loans. In the standardized world of GSE Guidelines, if the loan applicant does not fit the restrictive parameter, the loan is rejected - a relatively mechanical and inexpensive process. In subprime originating and underwriting, however, discovering the loan applicant's past credit problems is followed by individualized analysis of the nature of the credit problems and any revelant compensating or mitigating factors that might positively affect the applicant's ability or willingness to pay. This origination process is substantially more labor-intensive and costly than the process of originating loans pursuant to GSE Guidelines. Similarly, the servicing of subprime loans are more labor-intensive and costly. Unlike Prime Borrowers, many subprime borrowers are not accustomed to making regular loan payments over an extended time, and therefore a subprime servicer needs a substantially larger and more highly-trained customer service staff than does a servicer of loans to Prime Borrowers. As indicated previously, foreclosure results, almost if not entirely without exception, in a loss to the lender and servicer. Consequently, considerable resources are devoted to curing delinquent loans without foreclosure, requiring far more, and more highly trained, loss mitigation specialists than typically required for servicing Prime Borrowers.

Higher Costs of Funds. Unlike the GSE's, who have a line of credit with the U.S. Treasury and perceived government guarantee, Saxon must price according to its ultimate funding source. For some firms it is a portfolio approach of buying and holding loans. This is not the most efficient means of originating loans. Although somewhat insulated from the bond market's volatility, mortgage rates from a portfolio lender are higher than typical market rates. On the other hand, Saxon uses major investment banks to securitize the mortgage loans to fund its operations. The securitization process uses market rates and highly researched methods for rating and structuring bonds. The structuring/rating process accounts not only for the risks of the collateral, but of the Seller of the bonds, too. Transaction costs of securitization are higher for non-GSE's than for GSE's. Fees must be paid to accountants, the SEC, the underwriters, lawyers, and rating agencies. GSE's, in addition to being exempt from state and local income taxation, are exempt from SEC filing fees. GSE's also do not incur the professional fees related to compliance with SEC disclosure requirements, because they are exempt from such requirements.

Risk-Based Pricing. Saxon uses Risk-Based Pricing (RBP). This is not a new concept for the mortgage industry. RBP provides the company proper compensation for the risk incurred. RBP presupposes that the characteristics of a loan can indicate the likelihood of default. The factors that are in RBP can be either proprietary or purchased from an outside source. The independent rating agencies (*Standard and Poors*, *Duff and Phelps*, *Moodys*, and *Fitch*) have all published loss estimation algorithms and foreclosure frequency multipliers. Saxon uses these factors to build its pricing matrix. Some of the factors that play a role in RBP are credit grade; credit score; LTV; CLTV; documentation type; dwelling type; loan type and ownership type.

The aforementioned multipliers range in severity. For example, loans with a grade of "A+" have a factor of one. Meanwhile, a loan having a grade of "D" has a factor of 4.50. Thus, "D" loans are 4.5 times more likely to go into default than an "A+" loan. In another example, loans that are owner-occupied have a foreclosure multiple of one, while investment properties and second homes have a factor of three. This difference is the result of the greater propensity of borrowers to miss payments on homes other than their primary residence.

Because of RBP, Saxon's more inclusive product/program offerings, and the aforementioned higher costs of origination and servicing, it is difficult to compare a GSE Rate with a Saxon rate. The best way to examine the rate spread is by credit grade. Depending upon the credit grade, Saxon's rates range between 0.50 and 4.00 points over the GSE Rate.

Role of Prepayment Penalties.

Prepayment penalties reflect recapture of origination costs. Interest payments alone do not enable Saxon to recover its costs of origination and realize a reasonable profit with respect to loans that are paid off rapidly. Depending on the precise methodology used, a period of 18 to 24 months, or longer, is required in order for a subprime loan to reach a "break-even" point based on interest payments alone.

Prepayment penalties provide for more flexible and rational interest rates. Saxon offers borrowers the choice of rates with and without a prepayment penalty. Saxon builds the value of that penalty into its base rates. This results in approximately a 1/2 percent rate reduction for Saxon loans having a 3-year prepayment penalty. In addition, for a 5-year prepayment penalty, Saxon will lower a borrower's rate an additional ½ percent.

Prepayment penalties reduce funding costs. In recent securitizations, Saxon has pledged the prepayment penalty income as additional credit support for its securities. This generates credit enhancement cost savings, which can be passed on to the consumer in the form of lower rates.

ANSWERS TO OTHER QUESTIONS RAISED BY THE ANPR:

Q: Do housing creditors refinance their own (or an affiliate's) borrower's mortgage loans (including the financing of loan fees) at rates at or above those on the existing loan?

A: Saxon does not engage in this practice.

Q: What loans should be covered under HOEPA?

A: Saxon believes that the HOEPA thresholds of interest rates (applicable U.S. Treasury rate plus 10%) and "points and fees" (8%) are acceptable and reasonable triggers for enhanced "high cost" regulations. Saxon chooses to refrain from virtually all HOEPA lending, and expends considerable time and cost in screening loans to assure that no HOEPA loans are inadvertently originated or acquired. There does not appear to be any clear evidence that loans that are originated with rates and fees below the current HOEPA triggers are necessarily, or pervasively, abusive. On the contrary, most publicized accounts of abusive and predatory lending practices of which Saxon is aware appear to involve violations of existing HOEPA regulations, and thus could be remedies through increased enforcement of existing law.

Q: Should OTS impose limits on financing of certain fees or charges?

A: Subprime borrowers often are not affluent enough to amass the cash reserves typically required by GSE Guidelines. Therefore, borrowers should not be deprived of the option of financing reasonable, non-abusive closing costs. The costs should be clearly disclosed in advance. Existing law (in particular, RESPA) provides a mechanism for such disclosure. Many suggestions for improving and simplifying these disclosures have been put forward, and many of the suggestions would improve the borrower's ability to understand the mortgage transaction.

Q: Are limits on refinancing appropriate? Should OTS require lenders to determine the suitability of a mortgage loan product for a particular borrower?

A: Saxon closely scrutinizes refinancings of short-lived previous loans, and will not proceed with loans that appear to fail to provide reasonable, tangible net benefits to the borrower. Such analysis must be flexible and individualized to the borrower's circumstances. Rigid regulatory definition of when a refinancing is and is not appropriate would unduly restrict consumer choice and credit availability.

Q: Are limits on prepayment penalties, balloon payments, negative amortization, post-default interest rates and mandatory arbitration clauses appropriate for high-cost loans? Should OTS require institutions to notify applicants for high cost loans of the availability of home loan counseling programs before closing?

A: Such restrictions and enhanced disclosures are not necessarily inappropriate for high-cost loans, as "high-cost" is defined under current HOEPA thresholds. As stated above, there does not appear to be any clear evidence of abusive or predatory lending practices in the marketplace for loans that are below the current thresholds. Imposing any enhanced restrictions and procedural requirements for loans that are below the current thresholds should be approached cautiously to avoid unduly restricting credit availability and consumer choice.

As an example of recent regulations that Saxon considers to be overly broad, certain states have proposed or enacted enhanced restrictions of all "balloon payments". This may not necessarily be inappropriate for loans with balloon payments due only a few years after origination. However, such laws unnecessarily restrict loans amortized on a 30-year schedule and due, for example, in 15 years, which is a reasonable, mainstream product highly suited and appropriate for today's homeowners, including subprime borrowers.

Saxon appreciates this opportunity to comment pursuant to the ANPR. If I can answer any questions concerning these comments, or provided any additional information in support of this discussion, please to not hesitate to contact me.

Sincerely,

Richard D. Shepherd
Vice President and General Counsel