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Ref. Docket No. 2000-34, Responsible Alternative Mortgage Lending

Dear Sir or Madam:

Home Improvement Lenders Association (HILA) is pleased to submit comments on the above referenced Advanced Notice of Proposed Rulemaking. HILA is a non-profit trade association representing mortgage lenders who offer subordinated-lien mortgages for home improvement and other uses. Several members of HILA are savings associations directly regulated by OTS. Others are state-chartered and state-licensed lenders whose business could be significantly affected by any changes in OTS rules relating to alternative mortgages under the Alternative Mortgage Transactions Parity Act (AMTPA). Therefore HILA welcomes this opportunity to share its views with the OTS.

The Development and Role of the Home Equity and Subprime Lending Markets

We believe it is important that all federal and state regulators understand the benefits of maintaining a mortgage market that is free to innovate and provide homeowners the financing options they prefer. America enjoys the most open and least costly mortgage market in the world, and as a result also enjoys a strong economy and a high and increasing rate of homeownership.

Members of HILA provide financing to thousands of American homeowners every year who need to repair or upgrade their homes, consolidate other debts, and pay other family expenses such as college tuition. Home equity lending has grown substantially in the last several years, as more loan types and terms have become available, risks have become easier for lenders to manage, and consumers have become more knowledgeable about the advantages of this type of debt. In addition, as the value of homes has risen substantially in recent years, to a total of $9.4 trillion in 1998, home equity has become a major source of wealth for many American families,[1] and home equity loans help these families access this growing wealth without selling their homes. Home equity loans typically offer lower interest rates, longer terms, more tax advantages, and lower monthly payments than other forms of unsecured debt such as credit cards and signature bank loans. In recent years, HILA members and

[1] "The State of the Nation's Housing 2000," Harvard University Joint Center for Housing Studies, June 2000.

others have expanded this market to include new and innovative loan products that make lower-cost financing available even for homeowners with little or no equity in their homes.

Subprime lending is a relatively small but extremely important part of this market. Subprime lenders provide credit to homebuyers and homeowners that, in the not too distant past, would have been unable to obtain it at any price. (Many HILA members provide subprime loans, although most also provide financing to homeowners with standard credit, income, and loan-to-value ratios.) In the past, lenders deemed people with impaired credit, slim credit histories, low incomes, and/or little equity or cash for downpayments as simply too risky to lend to. Those few lenders who did lend to these riskier borrowers often did so at very high interest rates and for very short terms, in order to minimize and compensate for the risk. It was very easy for those lenders to take advantage of borrowers, and many did. There were not many of those lenders, however, so their practices and prices were rarely the subject of media or regulatory scrutiny.

In more recent years, however, more "mainstream" lenders, including national mortgage banking firms, national banks, and savings associations, have entered the subprime lending market. They have done so for several reasons:

- New tools such as credit scoring and more sophisticated underwriting models have enabled lenders to more accurately assess and price the risks associated with subprime lending.
- Federal and state regulators have placed greater emphasis on lending to first-time homebuyers, lower-income families, and other traditionally underserved populations that lenders have considered more risky, and have instituted both positive and negative incentives to encourage more lending to these populations.
- Capital markets have developed models and security structures that enable firms to pool subprime loans into securities that they can market to investors, opening up new lines of capital for subprime lending similar to those available in the conventional mortgage market.
- Increasing competition in the mortgage industry has pushed lenders into markets they would not previously have served in order to maintain and grow their overall market share.

All of these have been positive developments for borrowers. The increasing number of lenders and broader sources of capital involved in the subprime market has led to a reduction in overall prices for loans in this market in the last few years, according to our members. Thousands of first-time homebuyers and existing homeowners have, as a result, been able to obtain a first and/or second mortgage that is affordable and has enabled them to purchase their first home, make needed repairs and improvements to an existing home, finance their children's education, get out of burdensome credit card debt, and even refinance very high-rate mortgage loans made in previous years. Many borrowers have also been able to repair their credit and eventually refinance their subprime debt at lower, "prime" rates. Had they been unable to obtain a subprime mortgage loan, many of these borrowers would have been condemned to bankruptcy or continual financial hardship from high interest payments on credit cards, "paycheck loans," or other high-cost debt.

While the vast majority of firms recently entering the subprime market have been mainstream firms with solid reputations and business practices, the industry has, unfortunately, also attracted some less scrupulous people and firms. This has led to increasing scrutiny of this part of the market by the news

media, attorneys, and consumer advocates. In addition, the growth in the market and outreach by a larger number of lenders has led more people to seek a mortgage that might not have in previous years. Some of these people are less sophisticated about mortgage loan terms and pricing, not used to shopping for mortgages, and less capable of understanding and negotiating complex transactions. All of these factors together have led to a probable increase in "predatory" lending in the subprime market.

We are as concerned as OTS and other regulators about removing from the marketplace any lending that takes advantage of unsophisticated borrowers and/or leads to unnecessary foreclosures, costs that exceed those justified by the relative risk of the loan, and other financial hardship for homeowners. We also agree that it is appropriate for the OTS to review market trends to determine whether regulated institutions are engaging in practices that are harmful to consumers and present inordinate risks to the institutions. HILA is committed to working with the OTS and other regulators to address predatory lending practices in appropriate ways that will not unnecessarily limit consumers' options and access to mortgage credit.

This ANPR asks a number of questions about the subprime lending market, including the extent to which subprime lenders are invoking the AMTPA to avoid restrictions on certain loan terms enacted by the states, and the possible effects of OTS increasing restrictions on certain subprime loan terms and practices. In this letter, HILA will comment on several of these issues and also offer an overall opinion as to the approach we believe federal regulators should take to combat predatory lending most effectively.

Use of the AMTPA

HILA members generally offer subordinated-lien loans that are fixed-rate, fixed-term loans. These types of loans are not considered alternative mortgages under the AMTPA. However, some of our members also offer first mortgages, and variable-rate mortgages are currently a very popular option with consumers in a period of rising interest rates. Some of our members' loan programs also include prepayment penalties. We do not have any data on whether or to what extent lenders may be invoking the AMTPA to avoid restrictions a state has attempted to impose on these types of loans, or to what extent lenders may be deliberately structuring loans as alternative mortgages in order that they may fall under OTS rules. We do believe it is unlikely that the latter situation is widespread, if it exists at all.

Because HILA represents both regulated depositories, such as savings associations and federally-chartered banks, and state-chartered and state-regulated banks and mortgage lending institutions, we are keenly aware of any possible action that could cause an imbalance in the regulation of all these entities, or the imposition of rules at any level that would place any of these entities at a competitive disadvantage to others. While we understand the concern of OTS that the AMTPA may be providing ground for lenders to use OTS rules to engage in practices or use loan terms that one or more states are trying to eliminate, this possibility alone does not necessarily argue for stricter regulation by OTS. Such regulation might severely disadvantage savings associations in states where state-chartered institutions are not as heavily regulated.

We encourage OTS to try to find out exactly what state-chartered lenders may be doing to circumvent state regulation through the AMTPA. For example, are lenders misleading borrowers into believing

that variable-rate loans are actually fixed-rate loans, or failing to disclose balloon payments so the borrower believes he/she is getting an ordinary 15- or 30-year loan? If these are the real problems, we believe that OTS taking actions such as outlawing balloon payments or restricting rate adjustments will not solve them. On the contrary, what such restrictions would do is to limit the options available to consumers from savings associations and responsible state-chartered lenders, while failing to eliminate the real problems of deceptive marketing practices and lack of borrower knowledge.

Balloon payments, adjustable rates, and prepayment penalties are features that may be perfectly acceptable to, and even the best option for, some consumers. A balloon note with a long enough maturity may help lower the monthly payment for a borrower who is confident that he/she will sell the home before the balloon payment is due, or that interest rates will decline and he/she will be able to refinance the remaining balance before the balloon payment is due. In a rising rate environment, adjustable-rate loans allow borrowers to qualify that might not qualify for a fixed-rate loan, and are often a good option for borrowers who expect their incomes to increase. Prepayment penalties also can provide a lender with security to make a loan that it might not otherwise make, and can enable the borrower to qualify for a loan that he/she might not qualify for at the higher rate that might be charged without a prepayment penalty. In addition, an important concern for portfolio lenders in asset and liability management is that when interest rates decline, prepayment speeds increase. Prepayment penalties help portfolio lenders protect their assets against a falling interest rate environment.

Therefore we urge OTS in the strongest terms to be extremely careful in reviewing the situation before proceeding to restrict alternative mortgages in any way that would restrict options for borrowers to obtain reduced interest rates, lower monthly payments, and other favorable terms, or would jeopardize the asset management capabilities of portfolio lenders. We instead advise the OTS to work closely with state mortgage regulators and the Federal Trade Commission to ensure that OTS regulations and all other federal regulations are equally applied and enforced on state-chartered creditors.

Other Possible OTS Regulation of Subprime Lending

The ANPR also asks whether OTS should propose new restrictions and disclosures on "high-cost" mortgages issued by savings associations, and/or impose additional restrictions on those loans that might be deemed high-cost but are not currently subject to the Home Ownership and Equity Protection Act (HOEPA).

HILA strongly opposes any adoption by OTS of a definition of "high cost" mortgage that is different than that established by the Federal Reserve under HOEPA. We note that the recently published report of the Department of Housing and Urban Development and the Department of the Treasury recommends that the Federal Reserve use its authority under HOEPA to tighten restrictions, specifically to lower the interest rate/points and fees threshold at which HOEPA restrictions begin to apply.[2] We also are aware that the Federal Reserve has held hearings around the country about the effectiveness of HOEPA, and plans to hold additional hearings later this summer.

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[2] "Curbing Predatory Home Mortgage Lending: A Joint Report: June 2000" June 20, 2000 by the U.S. Department of Housing and Urban Development and the U.S. Department of the Treasury, p.7.

Because Congress expressly gave the Federal Reserve authority to adjust some of the restrictions of HOEPA, we believe that, absent any further legislation, it would be contrary to Congressional intent for another federal regulatory agency such as OTS to unilaterally impose additional HOEPA-like restrictions. Such unilateral regulation by OTS would create chaos in the national mortgage market, in which mortgage loans are regularly purchased and sold among savings associations, banks, and non-depository institutions. Savings associations that regularly purchase mortgage loans originated by banks or state-chartered lenders would have additional burdens of reviewing all purchased loans to ensure compliance with the tighter standards, which might not apply to other purchasers of those institutions' loans. In addition, because HOEPA provides that assignees are liable for any violation by the originator, institutions that purchase loans originated by savings associations would have to ensure compliance with different standards than those for loans originated by other sources that are subject only to HOEPA. This would be a nightmare for loan purchasers and securitizers.

Imposition of significantly lower interest-rate or points/fees thresholds by OTS might also inappropriately restrict or strongly discourage savings associations from making loans that may not be "predatory" at all, or even excessively costly or unreasonable given the borrower's risk profile and financial situation. For example, many subprime lenders routinely lend to borrowers who are on the brink of foreclosure. Needless to say, such a borrower is very risky to lend to and will be charged a high price, but even a relatively high-priced loan may be beneficial if the borrower is able to make the payments and save their home.

By tightening restrictions only on savings institutions (and, if AMTPA is invoked, state-chartered lenders), OTS could instead achieve a perverse result of discouraging subprime lending to such an extent that borrowers with impaired credit and/or low incomes have few sources of credit other than the true predatory lenders.

Defining and addressing "predatory lending"

Defining "predatory" lending is extremely difficult and often subjective. This ANPR asks for comment on possible restrictions on terms and practices that are commonly discussed as among those used by predatory lenders. While we have opinions on the relative merits of such restrictions, we would rather comment here that as federal regulators and legislators continue to examine predatory lending, they should first attempt to determine the true underlying causes of the problem as well as the true impacts, and then determine whether and how those problems can be solved and those undesirable impacts avoided.

Predatory loans have commonly been identified as having one or more onerous terms and/or high costs that exceed those justified by the risk profile of the borrower. However, in virtually all of these loans the real problem is that the borrower was not fully informed about those terms and/or costs, and as a result was unable to make the payments on the loan. Few, if any, borrowers knowingly accept a predatory loan that is going to strip the equity from their home, force them into bankruptcy or foreclosure, etc.

It seems to us that the biggest underlying causes of predatory lending therefore are: misleading and deceptive sales methods, such as high-pressure sales tactics that lead borrowers to sign applications,

disclosures, and closing documents that they do not understand or about which they are deliberately misinformed; deliberate failure to provide the required disclosures or point out terms such as prepayment penalties; and a lack of consumer awareness and ability to understand and negotiate the true costs and terms of their loans. Simply restricting or prohibiting certain loan terms such as prepayment penalties, credit insurance, balloons and negative amortization, and financing of fees and charges will not eliminate these problems.

However, as we have stated previously, such restrictions could hurt consumers by eliminating options available from honest lenders. Even a practice that may seem completely unethical, such as repeated refinancing, may not be predatory at all if the consumer has requested the refinancings and fully understands the true costs and other ramifications. Any attempts to prohibit or restrict such loan terms or impose a "suitability standard" are fraught with difficulty in drawing "bright lines" that clearly define a predatory loan yet do not restrict consumer choice.

More appropriate ways to address these underlying problems might include:

- increased enforcement of existing laws such as the Federal Trade Commission Act, which outlaws deceptive advertising and sales practices;
- better enforcement of the Fair Housing Act, which prohibits marketing and pricing that discriminates against protected classes of borrowers such as the elderly and minorities (in fact, at least one prominent fair housing advocate recently stated that virtually all systematic predatory lending is inherently discriminatory and thus could be stopped by simply enforcing the Fair Housing Act[3]);
- creating registries of mortgage brokers, lenders, and individuals that have violated existing laws, or have been reported to use deceptive sales tactics; and
- working with industry groups such as HILA to develop "best practices" guidelines which consumers can easily access to help them decide if their lender is engaging in illegal or unethical practices. HILA is currently developing such guidelines, has discussed predatory lending at all of our recent conferences, and sought to constantly remind our members that educated consumers are their best source of business. We also note that the Mortgage Bankers Association of America, the National Home Equity Mortgage Association, and the National Association of Mortgage Brokers have recently adopted best practices guidelines[4], and NAMB has committed to creating a national registry of brokers to root out those who engage in predatory practices.[5] These are practical steps that can be taken immediately to increase pressure on predatory lenders to stop their abusive practices, without limiting mortgage options for borrowers.

Congress might also consider increasing penalties and imposing criminal penalties on lenders who deliberately fail to provide the required disclosures at the required time, especially the initial Truth In Lending disclosure, the Good Faith Estimate of closing costs (currently there is no penalty for failing

[3] Shanna Smith, Executive Director, National Fair Housing Alliance, in remarks to a housing finance symposium hosted by Women in Housing and Finance, Washington, DC, May 31, 2000

[4] NAMB's guidelines apply to all forms of mortgage lending, while MBAA has adopted guidelines specific to subprime lending, and NHEMA's guidelines apply to all home-equity lending.

[5] "NAMB Plans Abusive Practice Registry," *National Mortgage News* Daily MortgageWire, June 27, 2000

to deliver a GFE), the HOEPA disclosure that failure to pay the loan could result in loss of the home, and the disclosure of the consumer's right to rescind a HOEPA loan. Another action at the state level that might be effective would be to impose individual licensing requirements and enforcement on loan officers and salespeople.

Consumer education is also a critical element in combating predatory lending. HILA strongly supports increased efforts by all regulators and industry to help borrowers better understand the mortgage process and alert them to the dangers of predatory lending practices. We are encouraged that HUD is planning to launch a nationwide consumer education campaign, including public service announcements with toll-free telephone numbers consumers can call to get information and locate a housing counseling agency in their area. We believe more consumer education efforts could be undertaken by organizations such as AARP, area agencies on aging, the NAACP, the national and state bar associations, and other organizations in a position of trust with potential victims of predatory lending. We support additional federal funding and possibly a cooperative industry fund to increase consumer counseling and education.

However, we caution OTS and other regulators against mandating counseling, even for high-cost loans. Good quality counseling is still not widely available, and a mandatory counseling requirement could lead to lower-quality counseling and even fraud such as forged counseling certificates. It would also penalize and possibly even stigmatize the majority of subprime borrowers who are well-informed and do not need counseling.,

Regulators should also examine the impacts of predatory lending to determine whether action can be taken to mitigate those impacts. One of the major and most distressing impacts of predatory lending is foreclosure. We are troubled by reports of high and increasing foreclosure rates among subprime borrowers in major cities across America.[6] HILA strongly believes that honest lenders never prefer to foreclose, and that good lending and servicing practices include making every effort to help a homeowner avoid foreclosure, whether through refinancing or restructuring the mortgage, selling the home, or other methods. HILA is committed to working with other industry organizations and federal and state regulators to develop additional ways to reduce the incidence of foreclosure.

Secondary Market Regulation

The ANPR asks if OTS should consider imposing a due diligence requirement on savings associations that purchase subprime loans. This concerns us greatly. Nearly all HILA members sell some or all of the loans they originate, including subprime loans. Many of our savings association members also purchase loans themselves and may purchase securities backed by subprime loans. We do not believe that loan purchasers should be held responsible for possible predatory practices of mortgage originators. As stated earlier, the terms and price of a loan themselves rarely, if ever, define a loan as predatory. But this is all the information available to the purchaser, securitizer, and investor. They do not have a reliable way of determining whether documents have been falsified, whether the borrower understood all the terms and costs of the loan, whether the loan is a third refinance in a year, etc. Very few lenders currently purchase HOEPA loans, and both Fannie Mae and Freddie Mac have recently

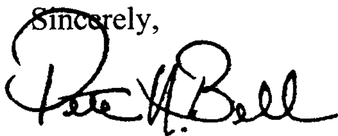
[6] "Curbing Predatory Home Mortgage Lending: A Joint Report" pp. 49-51

announced that they will not purchase them. Seeking to further turn the secondary market into a "police force" against predatory lenders will not work and is no substitute for strong enforcement by the responsible regulators.

Conclusion

We are very concerned about the growing movement toward regulation and legislation of the subprime mortgage market at the state and federal level that we believe would be excessive, driven by a sense of crisis rather than calm examination of facts and options, and likely to "solve the wrong problem" while failing to solve the real problems. We strongly urge OTS not to act unilaterally in imposing any new restrictions on mortgage originators or purchasers; rather, we advise OTS to: 1) defer to the Federal Reserve for adjustments to HOEPA; 2) work with state regulators to ensure the proper use of the AMTPA; and 3) develop solutions that focus on industry cooperation, better enforcement of existing laws, and better consumer education.

Sincerely,



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