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Revised

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July 7, 2000

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Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

RE: Multistate Comments on Docket No. 2000-34

Dear Sir or Madam:

Enclosed please find a revised version of the Comments of the National Association of Attorneys General submitted to you on July 5, 2000. The signature of Texas Attorney General John Cornyn was inadvertently added to the letter. This brings the total number of signatories to us, the Attorney Please accept these corrected Comments for filing.

Sincerely,

Sarah G. Reznick
Consumer Protection Counsel

Attachment

cc: Attorney General John Cornyn
Signatories to Comments

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RE: Multistate Comments on Docket No. 2000-34¹

Dear Sir or Madam:

This letter is submitted on behalf of the undersigned Attorneys General², in response to the Office of Thrift Supervision's ["the OTS"] advance notice of proposed rulemaking on Responsible Alternative Mortgage Lending, issued on April 5, 2000.

The issue of predatory mortgage lending is a major consumer protection concern of the state Attorneys General. We applaud the OTS for initiating this rulemaking process and for recognizing that abusive mortgage lending practices are matters for regulatory attention. We agree that the OTS has inadvertently contributed to predatory practices by promulgating regulations and issuing opinions that tend to preempt state consumer protection laws and we appreciate the OTS' willingness to take a fresh look at its rules and regulations.

We can attest that the practices cited by OTS Director Ellen Seidman in her statements to the House Committee on Banking and Financial Services on May 24, 2000, including unjustifiably high interest rates, excessive fees, oppressive balloon payment provisions, credit insurance "packing," loan "flipping," and prepayment penalties, are all too common in certain segments of the home credit marketplace. Although most lenders engage in responsible lending practices, a small

¹ Nothing in this letter should be taken to concede any of the issues pending for decision in any other proceeding that may be relevant or applicable, including *National Home Equity Mortgage Association v. E. Joseph Face, Jr. et al*, U.S. 4th Cir. Docket Nos. 99-2386, 99-2331(L), or the rights of consumers with existing loans to rely on applicable state consumer protection laws, including state prepayment penalty limitations.

²Of the states listed, Hawaii is not represented by its Attorney General. Hawaii is represented by its Office of Consumer Protection, an agency which is not a part of the state Attorney General's Office, but which is statutorily authorized to represent the State of Hawaii in consumer protection actions. For the sake of simplicity, the entire group will be referred to as the "Attorneys General," and such designation as it pertains to Hawaii, refers to the Executive Director of the State of Hawaii Office of Consumer Protection.

but significant percentage of lenders make highly abusive loans that strip the hard-earned equity from the homes of vulnerable citizens. The combination of the recent explosive growth in subprime lending, the relative paucity of regulation of non-bank creditors, and the unsophisticated nature of many subprime borrowers, all have contributed to an environment that is ripe for abuse.

Although the causes of predatory lending are many, we believe that one factor contributing to the recent growth of predatory lending is the Alternative Mortgage Transactions Parity Act ("Parity Act"). Congress enacted the Parity Act in 1982, during an unprecedented period of high interest rates complicated by restrictive state lending laws. The underlying purpose of the Parity Act was to expand available credit to home buyers by encouraging thrift institutions to originate "alternative mortgages"³ -- namely, mortgage loans other than traditional fixed-rate loans, including adjustable rate mortgages (ARMs). The Parity Act gave state-chartered institutions (depository and non-depository) parity with federal depository institutions to make such mortgages. If a state housing creditor followed the alternative federal scheme, the creditor was allowed to make alternative mortgages, notwithstanding any state laws or regulations prohibiting them.

Although the states recognize that the OTS does not have the authority to repeal the Parity Act, there is a serious question as to whether the Act continues to serve any useful purpose. The mortgage lending marketplace has undergone enormous changes since the early 1980s. Former restrictions on ARMs and first mortgage loan rates among the states have been largely eliminated. Moreover, as explained below, the Parity Act has allowed predatory lenders to shield themselves from state consumer protection laws intended to protect consumers from abusive mortgage lending practices.

In the experience of state Attorneys General, predatory lending is perpetrated primarily by non-depository lenders and mortgage brokers. As the OTS is well aware, these "housing creditors," unlike depository institutions, are subject to little regulation by the OTS or other federal agencies. As a result, an increasing number of these lenders purposely structure their mortgage loans, -- and, in particular, subprime loans -- as "alternative mortgage transactions" in order to rely on the preemptive effect of the Parity Act, and to evade state consumer protection laws without any counterbalancing federal regulation.

Under regulations promulgated by the OTS, state housing creditors are authorized to charge, without limitation, prepayment penalties and late fees in making alternative mortgage loans. *See* 12 C.F.R. §§ 560.34, 560.33. Many states, however, have consumer protection laws expressly

³Under the Parity Act, an "alternative mortgage transaction" is defined as: a loan or credit sale secured by residential real property, a dwelling, . . . or a residential manufactured home . . .

- (A) in which the interest rate or finance charge may be adjusted or renegotiated;
- (B) involving a fixed rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; [balloon loans] or
- (C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions . . .

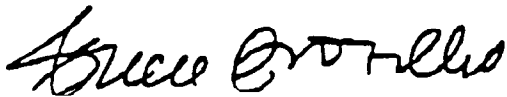
prohibiting or restricting prepayment penalties in mortgage loans, and regulating the amount of late fees that may be charged. Among other things, prepayment penalties serve to “lock” consumers into a loan for period of time, often up to five years, preventing the borrower from refinancing with another lender on more beneficial terms. Borrowers are thus penalized for attempting to get out of a high-cost loan and for seeking financing on better terms. Prepayment penalties also restrain competition, as they penalize borrowers who obtain financing from competing lenders, but the penalties are commonly waived when borrowers refinance with their existing lender. Moreover, consumers are often unaware that their loan contains a prepayment penalty, and learn of it only when they attempt to refinance.

The OTS’ regulations can, therefore, serve to encourage predatory practices by allowing state housing creditors to charge unlimited prepayment penalties and late fees on high-cost mortgage loans. Attached to this letter are summaries of recent selected consumer complaints about these practices. These summaries illustrate the plight of consumers trapped into oppressive home loans because of prepayment penalties. These consumers are typically of limited income, are financially unsophisticated, and most of them did not understand that their home loans were “alternative mortgage transactions” that contained prepayment penalties. In every case, the prepayment penalty would have been prohibited or greatly reduced if state law applied. In most of the cases, it appears that the lender structured the loan with an adjustable rate or a balloon payment to take advantage of OTS preemption without any corresponding benefit to the borrower. Indeed, we are seeing an increased incidence of loans containing 15-year balloons, or variable rates that automatically escalate regardless of market conditions. These terms are usually highly disadvantageous to borrowers and misunderstood by borrowers.

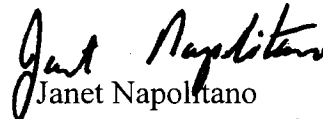
As the chief law enforcement officers of our states, we tend to look with disfavor on attempts to preempt state laws designed to protect our citizens, particularly when the federal regulatory scheme offers no similar protections. The OTS should seek to strengthen the states’ ability to protect borrowers from predatory practices. We strongly urge the OTS to take appropriate action to revise its regulations and opinion letters that preempt state consumer protection laws and allow unregulated lenders to impose unlimited prepayment and late payment penalties. We would recommend that the OTS either limit the deregulation of these penalties to conventional loans or remove such penalties from the list of regulations that are applicable to state-licensed housing creditors.

We appreciate this opportunity to express our views on this matter. We look forward to working with the OTS in mutual efforts to address the problem of predatory lending. Please feel free to contact any one of us directly, NAAG Legislative Director Lynne Ross, at 202-326-6054, or NAAG Consumer Protection Project Director Sarah Reznick, at 202-326-6016.

Sincerely,



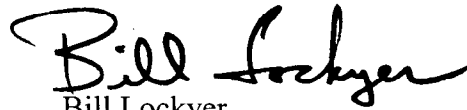
Bruce M. Botelho
Attorney General of Alaska



Janet Napolitano
Attorney General of Arizona



Mark Pryor
Attorney General of Arkansas



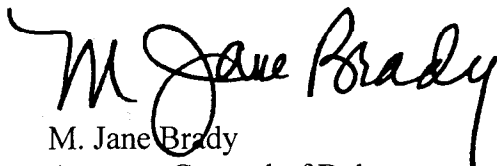
Bill Lockyer
Attorney General of California



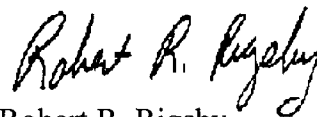
Ken Salazar
Attorney General of Colorado



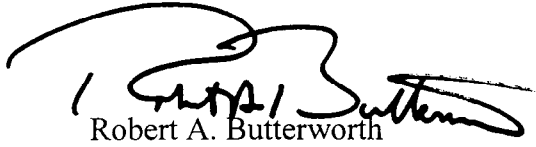
Richard Blumenthal
Attorney General of Connecticut



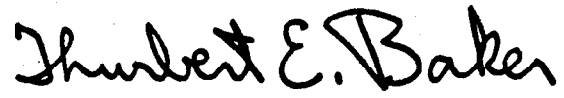
M. Jane Brady
Attorney General of Delaware




Robert R. Rigsby
Corporation Counsel of D.C.



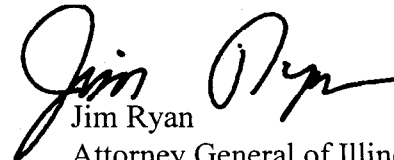
Robert A. Butterworth
Attorney General of Florida



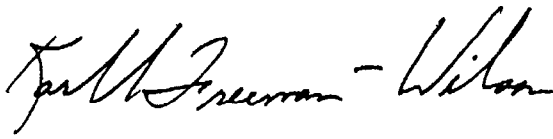
Thurbert E. Baker
Thurbert E. Baker
Attorney General of Georgia



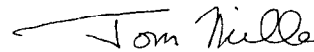
Stephen H. Levins
Acting Executive Director
Hawaii Office of Consumer Protection



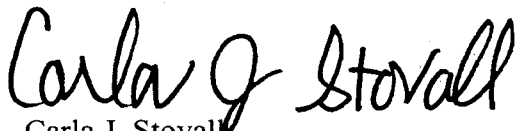
Jim Ryan
Attorney General of Illinois




Karen Freeman-Wilson
Attorney General of Indiana



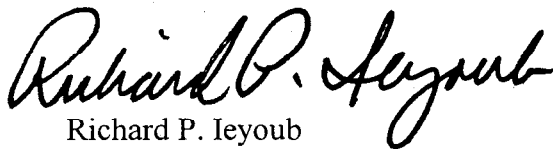
Tom Miller
Tom Miller
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Carla J. Stovall
Carla J. Stovall
Attorney General of Kansas



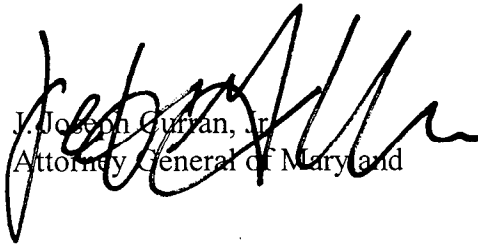
A.B. "Ben" Chandler III
A.B. "Ben" Chandler III
Attorney General of Kentucky



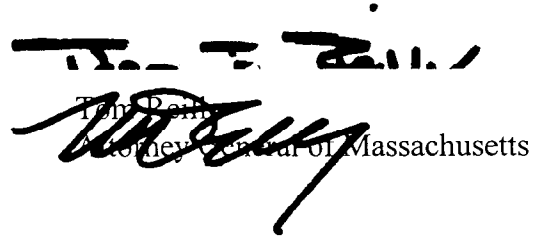
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Richard P. Ieyoub
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Andrew Ketterer
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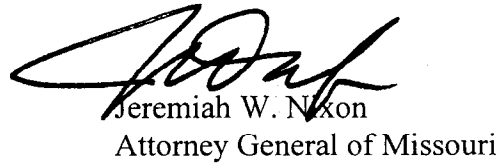
Tom Bell
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Mike Moore

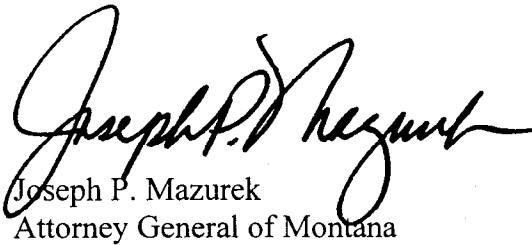
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Mike Hatch
Attorney General of Minnesota

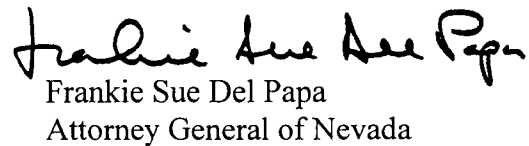
Mike Moore
Attorney General of Mississippi



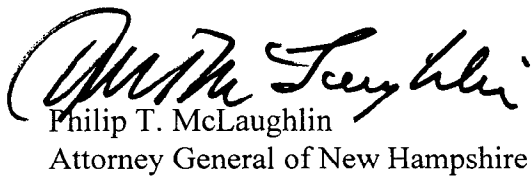
Jeremiah W. Nixon
Attorney General of Missouri



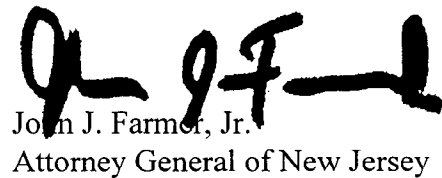
Joseph P. Mazurek
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Philip T. McLaughlin
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W. A. Drew Edmondson
Attorney General of Oklahoma



Hardy Myers
Attorney General of Oregon



D. Michael Fisher
Attorney General of Pennsylvania



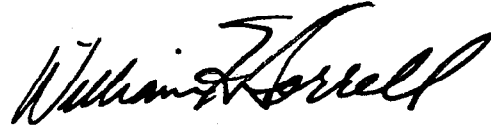
Sheldon Whitehouse
Attorney General of Rhode Island

Charlie Condon
Attorney General of South Carolina

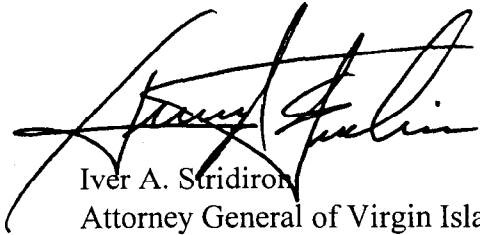
Paul Summers
Attorney General of Tennessee



Jan Graham
Attorney General of Utah



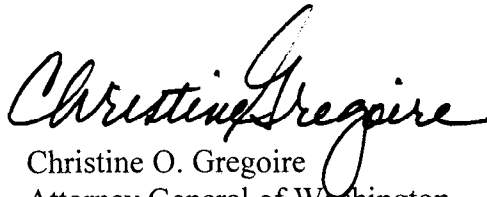
William H. Sorrell
Attorney General of Vermont



Iver A. Stridiron
Attorney General of Virgin Islands



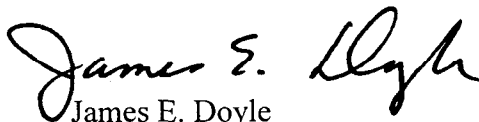
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Christine O. Gregoire
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Attorney General of West Virginia



James E. Doyle
Attorney General of Wisconsin



Gay Woodhouse
Attorney General of Wyoming

ATTACHMENT

CONSUMER COMPLAINT SUMMARIES

- In 1999, PB received a loan of \$71,000 at the fixed rate of 14.99%. The note provided that the interest rate was subject to very minor reductions of the interest rate in the amount of .25% at the end of the third, fourth, and fifth years of PB's loan, but only if PB made all payments on time. The note imposed a prepayment penalty equal to six months interest if the loan was paid off within the first five years of the loan -- i.e., 7.5% of the loan's outstanding balance. (State law prohibited prepayment penalties on this type of loan.) The loan also contained a late fee provision, authorizing the lender to charge 10% of the payment amount, if the payment was more than 15 days past due. (State law only authorized a late fee of 4%.) This year, PB was able to refinance with another lender at a rate of 10.99%, but was assessed a prepayment penalty of \$5,245. PB was unaware of the prepayment penalty provision until she refinanced the loan. The lender claimed that the loan was an "alternative" mortgage pursuant to the interest rate reduction clause.
- In 1999, AB obtained a loan in the amount of \$43,750, at an APR of 13.74%. Total settlement costs on the loan were \$9,149, including a 6% loan origination fee. The loan terms included a \$2,680 yield spread premium paid to the mortgage broker who arranged the loan. The loan had a balloon payment of \$38,348 which would be owed by the borrower after 15 years of payments on the loan. AB was unaware of the balloon payment provision until an attorney advised her several months after the loan closed. The loan contained a prepayment penalty (prohibited by state law) equal to six months interest within the first five years of the loan. Because of the balloon payment provision, the note asserted that the loan was an alternative mortgage.
- CD obtained a debt consolidation loan in the amount of \$70,693, at an APR of 14.16%. CD told the lender that she intended to pay off the loan within a year, when she planned to move into her mother's home. The lender assured CD that there would be "no problem" with paying off the loan early, leading CD to believe that there were no penalties. Contrary to the lender's oral representations, the note imposed a prepayment penalty equal to six months interest if the loan was paid off within the first five years of the loan, which is equivalent to 7% of the loan's outstanding balance. (State law prohibited prepayment penalties.) The note further provided that the interest rate was subject to future reductions of .25% after the third, fourth, and fifth years of the loan, if CD made all payments on time. The note asserted that the loan was an alternative mortgage. The loan also contained a late fee provision, authorizing the lender to charge 10% of the payment amount, if the payment was more than 15 days past due. (State law authorized a late fee of 4%.) Four months later, CD requested a payoff amount from the lender, so that she could set the selling price of her existing home. She was told that the payoff amount was \$70,683. Shortly before closing, however, CD was told that the payoff would be \$76,724. When CD questioned the differing payoff amounts, the lender told her that the penalty was disclosed only when the attorney handling the closing

requested the payoff. The lender offered to make a consumer loan to CD at the rate of 19% to pay the prepayment penalty.

- In 1999, MT obtained a loan of \$70,000. The lender charged an origination fee of 7%. The loan is an ARM with an initial interest rate of 10.83%, but the rate is guaranteed to increase by 1% every six months to at least 16% (under current market conditions) with a maximum rate of 17.825%. MT is on a fixed income, and understood that his loan would be at a fixed rate of 10.8%. When MT noticed the adjustable rate at closing, he was assured by the lender that his payments would not go up by more than \$2 to \$3. Instead, MT's payments may actually go up by almost \$400. The loan contains a prepayment penalty (prohibited by state law) permitting the lender to collect twelve months advance interest on any amount prepaid within five years. MT will likely face foreclosure or bankruptcy in the near future, as he cannot refinance this loan due to the prepayment penalty.
- HH obtained a home equity line of credit, secured by a second mortgage, in the amount of \$26,000, at an APR of 16%. The note imposed a prepayment penalty equal to six months interest if the loan is paid off within the first five years. (State law restricts prepayment penalties on second mortgages to 2%, which may be imposed only during the first three years of the loan.) The interest rate purports to be adjustable with a base index of 15.9% and a maximum of 16%. Thus, the interest rate on the note can fluctuate, at most, between 15.9% and 16%. The lender asserts that the loan is an alternative mortgage.