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From: Cotney-DOB, David [David.Cotney@state.ma.us]
Sent: Wednesday, July 05, 2000 2:26 PM
To: public.info@ots.treas.gov
Subject: Docket No. 2000-34

OTS ANPR

ALTERNATIVE MTG LENDI...

Attached please find the comments of the Division of Banks with regard to the advanced notice of proposed rulemaking by the Office of Thrift Supervision. If anyone has any questions, please feel free to contact me at the number below.
Thank you.

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July 5, 2000

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

Attention Docket No. 2000-34

Dear Sir or Madam:

This letter is written in response to the Office of Thrift Supervision's (OTS) request for comment on the advance notice of proposed rulemaking. The Division of Banks (Division) appreciates the opportunity to assist the OTS in the review of its mortgage lending regulations. The Division commends the OTS for taking steps to identify problems in federal regulations that curb the ability of states to protect consumers and inadvertently contribute to predatory lending practices.

Congress enacted the Alternative Mortgage Transaction Parity Act (Parity Act) in order to help facilitate the development of alternative mortgage transactions. As allowed under section 3804 of the Parity Act, the Commonwealth of Massachusetts opted out of the preemption provisions of section3803 of the Parity Act (see St. 1985, c.244). Although Massachusetts opted out of the preemption provisions of the Parity Act, nevertheless, the Division believes that the Parity Act may have outlived its original intent and have the unintended consequence of fostering predatory lending practices.

The Division's Consumer Compliance Unit examines 313 state-chartered depository institutions and over 2,500 licensed non-bank financial service entities, including 700 mortgage lenders and mortgage brokers, for compliance with applicable state and federal consumer protection statutes and regulations. The Division maintains a longstanding exemption from Regulation Z from the Board of Governors of the Federal Reserve System (the "Board"). The Commonwealth of Massachusetts regularly enacts amendments to Massachusetts General Laws Chapter 140D, the Consumer Credit Cost Disclosure Act, to conform to any amendment of the Truth in Lending Act. The Division, through its broad rule-making authority, also amends 209 CMR 32.00 *et seq., Disclosure of Consumer Credit Costs and Terms,* our state truth in lending regulations, in order to parallel any amendments to Regulation Z promulgated by the Board and to offer the greatest consumer protection. The Division's authority to amend this regulation will also be utilized to address the consumer protection needs of the citizens of Massachusetts in high cost-high fee mortgage loan transactions. Amendments have been drafted to the Division's regulation 209 CMR 32.32, in part, to lower the threshold upon which a mortgage loan is considered covered by this section. These proposed

amendments will be similar to the initiatives taken by the states of North Caroline and New York. This section at present mirrors Section 32 of Regulation Z and affords the protections of the Home Ownership and Equity Protection Act. The Division has also drafted proposed regulations to address, define and enforce unfair and deceptive acts and practices committed by depository institutions within the Commonwealth. Both of these regulatory initiatives are expected to be finalized by calendar year end.

The Division's Consumer Compliance Unit also has the responsibility, through its licensing and examination of non-bank financial service entities, of ensuring the safe and sound operation of these entities. In its capacity as a financial services regulator, the Division shares the mission of the OTS to encourage the safe and sound, efficient delivery of low-cost credit to the public free from undue regulatory duplication and burden. However, the assumption inherent in the belief that most components of a loan contract should be a matter of negotiation is that both parties of the transaction have equal bargaining power. It is the experience of the Division, through its examination findings and mediation efforts in resolving consumer complaints, that the theory of equality in the negotiation does not always occur in practice. This is most obvious in the case of the distressed borrowers that we are more likely to see in "subprime" mortgage loan transaction; but the lack of variation in specific terms in any given loan portfolio indicates the lenders' disinclination to negotiate.

The following represent various examples of predatory lending practices in the Commonwealth of Massachusetts revealed as the result of consumer complaints or examinations/inspections of mortgage lenders conducted by the Division. Also provided are the actions taken by the state to protect its consumers.

- As a result of a consumer complaint, it was revealed that a mortgage lender had charged 10 points, charged an adjustable interest rate of 10.99%, and was foreclosing against a consumer. The state's Attorney General pursued litigation against the lender as violating Attorney General's regulation 940 CMR 8.06(6), namely that "[i]t is an unfair or deceptive act or practice for a mortgage broker or lender to procure or negotiate for a borrower a mortgage loan with rates or other terms which significantly deviate from industry-wide standard or which are otherwise unconscionable." The U.S. District Court for the District of Massachusetts affirmed the Attorney General's position and prohibited the lender from charging more than five points (Civil Action Case No. 96-12538-WGY). The Division has used five points as an important threshold or rebuttable presumption of unconscionability in its examinations of licensed mortgage lenders. Any lender charging more than five points must affirmatively demonstrate that these fees are within industry-wide standards.

- A recent examination/inspection by the Division revealed that a mortgage lender routinely charged high points (up to 23 points) and high fees (up to $1,599) in connection with transacting residential mortgage loans. The results of the examination/inspection were referred to the state's Attorney General. The Attorney General pursued litigation against the lender. The litigation is ongoing while the lender has been prohibited from charging more than five points.

- As a result of an examination/inspection by the Division, it was revealed that a mortgage lender refinanced a borrower three times over the course of three months with each refinancing resulting in a higher interest rate, 5 points charged at each occurrence, and repeated charges for single premium insurance costs. The results of the examination/inspection were presented to the mortgage lender. The mortgage lender revised its policies and procedures to lessen points and premiums charges and reduce the number of refinancing transacted.

- In 1999, the Division recovered approximately $80,000 on behalf of consumer from predatory lenders. This figure would not necessarily include those instances where the lender, as result of an examination/inspection or other contact by the Division, renegotiated the unconscionable terms of a mortgage loan.

General

The best avenue to ensure that consumers obtain the products that best suit their needs and means is competition and access to information. Massachusetts' consumers have access to mortgage loan products from over 700 licensed mortgage brokers and lenders, in addition to several hundred state and federally chartered depository institutions. Information about the various products and services is abundant in all forms of media. Although, with specific reference to state-regulated housing creditors, the OTS is evaluating the necessity to amend its regulations as they apply to subprime and predatory lending, the OTS may also find it beneficial to review the relevance of the Alternative Mortgage Transaction Parity Act in light of the market conditions that exist today. These include, but are not necessarily limited to, the widespread acceptance and availability of adjustable rate mortgage loan products, the current relatively stable interest rate environment, and the abundant supply of mortgage lenders.

The OTS is authorized, under its original enabling act, 12 USC § 1464(a)(2) (the Home Owners' Act), "to issue charters therefor, giving primary consideration of the best practices of thrift institutions in the United States." At the time of the Home Owners' Act's enactment, the referenced "thrift institutions" were state-chartered institutions. The Division believes that the individual states are in the best position to protect their citizenry while fostering competition. The exposure of predatory lending abuses has put new attention on the importance and continued relevance of consumer protection regulation and enforcement. Federal law and regulation should not preclude a state from protecting its citizens. The Division believes that federal thrifts and housing creditors should, to the fullest extent possible, comply with the most consumer protective provisions of federal or state law or regulations. At a minimum, federal thrifts and housing creditors should comply with state consumer protection provisions for all high cost home loans.

Response to Requests for Comments

The Division would also like to respond to several of the questions raised by the OTS in its request for comments. Below are the Division's responses to the specific questions.

Should OTS Modify Its Regulations Implementing the Alternative Mortgage Transactions Parity Act?

Yes. As noted above, the Parity Act should not be used to preempt a state's ability to protect its consumers. The Division considers state consumer protections to be "best practices" that all lenders should comply with. As an example, Massachusetts limits prepayment penalties to three years (G.L. c. 183, s. 59). The Division considers the five-year limit under the Homeowners Equity and Protection Act (HOEPA) to be excessive and that all lenders should comply with the Massachusetts limitations.

Should OTS Adopt Regulations on High-Cost Mortgage Loans?

The Division fully supports the adoption of regulations with respect to high-cost mortgage loans, provided however, that such regulations do not interfere with a state's ability to adopt more consumer

protective provisions. As noted above, the Division is preparing to propose regulations similar to those proposed by New York. The Division would support the OTS adopting the provisions proposed by New York, including: lowering the threshold for the definition of a high cost home loan, limiting the financing of certain fees or charges, prohibiting the frequent refinancing of high cost home loans (also known as "flipping"), prohibiting oppressive mandatory arbitration clauses, and requiring that lenders determine the suitability of a high cost home loan for a borrower based on "verified" information. In addition, the Division believes that, at a minimum, borrowers should be made aware of credit counseling. Consideration should also be given as to whether credit counseling should be mandatory for any borrower that applies for a high cost home loan.

Is Differential Regulation Appropriate?

Yes. Similar to other activities, the OTS should differentiate among thrifts that wish to engage in subprime or high cost home lending. Institutions that have unsatisfactory safety and soundness, consumer compliance, or Community Reinvestment Act (CRA) ratings should be closely reviewed before they are permitted to engage in such activities. With respect to Massachusetts housing creditors, the Division disagrees with the statement that "State-regulated housing creditors are not subject to the same level of regular comprehensive examination as federally-insured depository institutions." In addition to rigorous licensing requirements, the Division performs regular examinations of all mortgage lenders for safety and soundness and consumer compliance. The OTS should consider how it can work with the state regulatory agencies to increase coordination and cooperation in this area.

How Should OTS Deal With Potential Lending Issues Raised by Thrift Subsidiaries or Affiliates?

The Division encourages the OTS to amend all applicable regulations to ensure adequate oversight of subsidiaries and affiliates and that they comply with all applicable consumer protection provisions. The Division believes that corporate subsidiaries or affiliates should not be used to subvert state consumer protection provisions. The Division also encourages the OTS to examine the practices of subsidiaries and affiliates to ensure that they are held to the same standards as the parent federal thrift.

Should OTS Impose Certain Due Diligence Requirements?

Yes. The Division believes that due diligence on potential loan purchases in the secondary market is consistent with the principles of safety and soundness. Failure to perform due diligence can expose the federal thrift to compliance, reputational, and legal risks. In addition, financial institutions which engage in or facilitate predatory lending activities (including either directly or indirectly providing mortgage loans with unconscionable terms; purchasing loans made with predatory terms; or investing in mortgage-backed securities or other investment vehicles consisting of loans made with predatory lending terms) are working against the spirit and intent of the CRA. These types of activities have a negative impact on low and moderate-income individuals. Further, if concentrated within a particular geographic area, predatory lending can have a destabilizing effect on communities. Under CRA, financial institutions have an obligation to ensure that they do not engage in any practices that would negatively impact low and moderate-income individuals or geographies. As such, it is the Division's strong belief that financial institutions should be required to exercise due diligence to ensure that their actions, such as purchasing loans or investing in mortgage-backed securities do not support the proliferation of predatory lending. Financial institutions should be required to investigate the rates and terms associated with loans they are considering for purchase or loans that securitize investments they are considering.

Effect of Predatory Lending Practices on CRA Performance

It is the Division's belief that participation in predatory lending practices should have an adverse impact on an institution's CRA performance rating. The Division believes that a financial institution's participation in activities that disadvantage low- and moderate-income individuals should be considered when evaluating the institution's CRA performance, regardless of whether or not the activity occurs inside or outside of the institution's assessment area or if the institution is considered a "small" institution for the purposes of CRA. Institutions which engage in predatory lending practices should be subject to closer scrutiny and more frequent examinations. On the other hand, those institutions that engage in responsible lending and remain proactive in addressing the needs of low and moderate-individuals through the development of non-predatory products and services should receive appropriate recognition during examinations for CRA compliance.

Thank you for the opportunity to comment. If you have any questions, please feel free to contact me at (617) 956-1500, extension 513, or David J. Cotney, Deputy Commissioner for Consumer Compliance at extension 542.

Very truly yours,

Edward J. Geary
First Deputy Commissioner of Banks

cc: Neil Milner, Conference of State Bank Supervisors