

---

# CONSUMER MORTGAGE COALITION

---

61

July 5, 2000

Manager, Dissemination Branch  
Information Management and Services Division  
Office of Thrift Supervision  
1700 G Street, N.W.  
Washington, DC 20552  
Attention: Docket No. 2000-34

2000 JUL -7 A 9:32  
RECEIVED  
OFFICE OF THRIFT SUPERVISION  
INFORMATION MANAGEMENT AND SERVICES DIVISION

Re: Advanced Notice of Proposed Rulemaking  
Responsible Alternative Mortgage Lending

Dear Sir or Madam:

The Consumer Mortgage Coalition ("CMC"), a trade group of national residential mortgage lenders and servicers, appreciates the opportunity to submit its views concerning the Advanced Notice of Proposed Rulemaking ("ANPR") which the Office of Thrift Supervision ("OTS") published in the Federal Register on April 5, 2000 (65 Fed. Reg. 17811-17818). The ANPR, entitled "Responsible Alternative Mortgage Lending," gives notice that OTS is reviewing its mortgage lending regulations, both as they apply directly to federal thrifts and as they apply to non-federally-chartered housing creditors through the Alternative Mortgage Transactions Parity Act (the "Parity Act"), 12 U.S.C. §§ 3801 *et seq.*

We applaud the initiative of the OTS in reviewing its regulations with the goal of "encouraging the safe and sound, efficient delivery of low-cost credit to the public free from undue regulatory duplication and burden." 65 Fed. Reg. 17811. In our opinion, these regulations have established highly effective alternative mortgage lending standards. The OTS's rules implementing the Parity Act have not only reduced the cost to lenders of complying with duplicative state regulations, but in addition by allowing greater uniformity of terms have made much easier the securitization of alternative mortgage loans. These developments have lowered the cost of credit to consumers across the nation.

To retreat from these standards by enforcing an unduly narrow interpretation of the Parity Act, will harm consumers while doing nothing to achieve the OTS's overarching goal -- either in general or with respect to the specific need to curb predatory lending. We are not aware that the Parity Act has ever been a vehicle for abusive lending, and as a result we do not believe that reform of the OTS's Parity Act regulations should be the focus of OTS's consumer protection efforts. The OTS can best show its commitment to a safe, sound, efficient and consumer-friendly national mortgage lending system by engaging with the mortgage-lending industry to advance comprehensive mortgage reform. Only such an approach can deal with the problem of

predatory lending without incidentally damaging the broader interests of consumers and the lending industry.

### **Predatory Lending**

As the ANPR points out, predatory lending practices “prey upon customers’ lack of knowledge or options.” 65 Fed. Reg. 17812. The home-mortgage horror stories with which the media have acquainted us tend to share two characteristics: borrowers do not fully understand the terms of the loans they are obtaining, whether through lack of education, advanced age, poor physical health or other infirmities; and borrowers obtain their loans without comparing terms and conditions with other competing loan products, whether through reluctance to shop for credit or due to a lack of adequate competition. If every borrower understood the terms of the loan she was obtaining, and if she had access to competing products with different mixes of terms and conditions, far fewer stories would circulate of borrowers victimized by unscrupulous lenders.

If inadequate consumer education and lack of consumer choice are the primary factors that permit predatory lending to persist, then the way to curb predatory lending is to address those factors. Consumers need to know, in practically useful ways, what the terms and conditions of the loans they are considering actually mean. They need to be able to compare one loan with another according to the factors that are of real importance. And they need to have access to more than one or two lenders to obtain credit. The best protection against abuses by unscrupulous lenders is the existence of aggressive competitors who can deprive those lenders of business by offering better deals to borrowers.

We understand that not all analysts of the predatory lending problem share our views on the solution. Some consumer advocates, together with some state legislatures and city councils, believe that certain loan terms and conditions -- balloon payments, negative amortization, high loan-to-value ratios, mandatory arbitration and/or prepayment penalties, for example -- are intrinsically unfair and should be prohibited or sharply curtailed. The CMC, however, agrees with the OTS that such a position ignores the fact that the crucial issue is whether the terms were “misunderstood by an unsophisticated borrower pressured into accepting them.” 65 Fed. Reg. 17814. In other words, a so-called *predatory* loan is often really a *fraudulent* loan or one made pursuant to a deceptive trade practice. To the degree that spirited competition does not solve the predatory lending problem, aggressive enforcement of existing state and federal laws, rather than enactment of new substantive lending prohibitions, is the appropriate path to take.

In fact, the terms and conditions unfairly stigmatized as predatory often have specific benefits to borrowers. Take the example of prepayment penalties. A lender requires a prepayment penalty as a way of hedging the risk that the borrower may refinance her loan. As a result, lenders can and do profitably charge lower interest rates on loans with prepayment penalties. Thus, a subprime borrower who would otherwise only be able to obtain a loan at 11% may be able to obtain the same loan at 10 ¼ %, if she is willing to accept a prepayment penalty. The difference in monthly payments between a loan at 10 ¼ % and one at 11% can be crucial to a working family, and the Parity Act itself amounts to Congressional recognition of this fact -- if a housing creditor were not able to charge prepayment penalties to our hypothetical subprime

borrower, a federal savings bank able to charge such penalties would always be able to offer a lower rate and compete successfully against the housing creditor in obtaining the borrower's business. Other controversial terms and conditions carry equally concrete benefits:

- Balloon payments permit borrowers to obtain lower-cost credit than they would otherwise be able to, by assuming the risk of possible interest-rate increases and possible decline in their creditworthiness or the value of the collateral by the end of the balloon term. They also permit borrowers to leverage positive changes in their economic circumstances that are anticipated at some point in the future.
- Negative amortization on adjustable rate loan transactions permits borrowers to obtain credit with a capped or fixed monthly payment, thereby giving borrowers the benefit of limiting their payment risk without incurring the higher rates required to compensate the lender for taking the additional interest-rate risk on a fixed-rate loan.
- Mandatory arbitration lowers the cost of credit to borrowers by making secondary-market sales of loans more attractive to investors and servicers. It reduces the risk of frivolous class-action lawsuits, which are a significant source of expense particularly in the secondary market for loan servicing. At the same time, mandatory arbitration preserves the ability of borrowers to obtain redress of actual problems.
- High loan-to-value ratio loans used as debt-consolidation devices permit borrowers to obtain significant amounts of credit at relatively low home-mortgage rates with which to pay off loans at relatively high unsecured-credit rates. This permits borrowers to make substantially lower total monthly payments and often receive some tax savings, both of which make possible earlier paydown of loan balances. High loan-to-value ratio loans used as purchase-money loans permit people to buy a home who could not otherwise because they lack downpayment funds.

Attempting to solve the predatory lending problem by prohibiting certain loan terms might eliminate some lending abuses, but only at the cost of prohibiting the vast majority of borrowers from benefiting from the flexibility and savings that these terms can provide. And such prohibitions would not deter unscrupulous lenders from putting undue pressure on borrowers to avoid making the sort of full, clear disclosure that alone can put a borrower on effective notice. We are encouraged that the OTS appears to agree with us that “[g]enerally, the market should drive the products offered[,] and terms and conditions in loan contracts should be the result of negotiation between well-informed borrowers and lenders.” 65 Fed. Reg. 17812.

### **The Role of the Parity Act in Curbing Predatory Lending**

Based on this understanding, the CMC thinks that the Parity Act, far from encouraging predatory lending, may actually play a role in curbing predatory practices. The Parity Act, whose basic thrust is to permit lenders not chartered by the federal government to make alternative mortgage loans on the same terms as federally-chartered lenders, dramatically opened the lending market in the 26 states that in 1981 prohibited or severely restricted such lenders

from making such loans. *See* 65 Fed. Reg. 17813. This stimulated a dramatic increase in competition that directly benefited borrowers: it lowered the cost of credit in general, and it stimulated lenders to create new products more closely tailored to the needs of various subgroups of borrowers. Lower prices and enhanced competition have operated as a constant pressure to prevent most lenders from offering uneconomic loans with undesirable terms and conditions. This is not to say that lending abuses do not occur, only to say that they occur in spite of the Parity Act, not because of it.

The Parity Act and the OTS's implementing regulations should not be discarded merely because they have not been a comprehensive solution to the nation's mortgage-finance problems. Together with the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA"), 94 Stat. 132 *et seq.* (March 31, 1980), the Parity Act remains one of the cornerstones of nationwide lending standards. Limiting its preemptive reach to those state laws that explicitly deal with alternative mortgage transactions, which the OTS has suggested as a possible course of action, *see* 65 Fed. Reg. 17815, would effectively end the usefulness of the Parity Act: it would reintroduce the competitive differences between federally-chartered lenders and all others that Congress opposed in the first place, only in a slightly covert fashion. The Virginia statute that the National Home Equity Mortgage Association ("NHEMA") sued to enjoin, for example, appeared to limit prepayment penalties with respect to all mortgage loans. *NHEMA v. Face*, 64 F.Supp. 2d 584, 587-588 (E.D.Va. 1999). But because federal savings banks are exempt from such a law, the Virginia limitation on prepayment penalties would only apply to nonfederally-chartered housing creditors. If the OTS were to interpret the Parity Act as preempting only those statutes that explicitly deal with alternative mortgage transactions, it would let stand laws like Virginia's. Such an interpretative posture would thereby establish drastic competitive limitations on alternative mortgage lending in whole states, effectively undermining the intent of Congress in enacting the Parity Act. Such a result would burden the lending industry in general, limit choices of consumers and potentially raise the cost of credit in states such as Virginia as competition dwindled. Nevertheless, it would still not strike at the root factors permitting predatory lending: inadequate knowledge, inadequate choice, and inadequate enforcement of fraud statutes already on the books.

### **Mortgage Reform as a Comprehensive Solution to Predatory Lending**

If the goal of the OTS is to curb predatory lending, it only has three options: to try to use its Parity Act authority, to leave such initiatives up to the states, or to join the CMC and other industry representatives in advocating comprehensive federal mortgage reform. Even the most aggressive use of its Parity Act authority can only give OTS authority over some lending by some lenders in most states. Leaving predatory lending initiatives up to the states abdicates OTS's responsibilities to protect the availability of residential mortgage credit and its ability to influence policies, jeopardizes nationwide competition in mortgage lending, and still does not guarantee that vulnerable consumers will be protected. But comprehensive mortgage reform, if practical, substantively effective and supported by the federal banking agencies, can guarantee that all borrowers will receive adequate and appropriate information about their loans, and by stimulating head-to-head competition for all loan products will go farther towards ensuring that all categories of consumer have adequate choice of financial services than any preemptory

government order. The CMC has consistently advocated a package of reforms, whose principal features are:

- *Early Disclosure of Firm Closing Costs* leading to greater certainty for consumers on closing costs and to increased price competition for both loans and ancillary services required to make the loan;
- *Improved Prequalification Shopping* by providing consumers with more precise information about the loan they are likely to qualify for prior to the consumer paying an application fee;
- *Proportional Remedies* so lenders are the target of less litigation over harmless or minor errors while consumers can be compensated for actual harms;
- *Substantive Protections* to protect the most vulnerable consumers from abusive loans;
- *Foreclosure Reforms* to provide additional protections to borrowers facing the loss of their home without reducing the value of lender's security interest in the property.
- *Federal Preemption* of state laws so that lenders can comply with a uniform set of requirements which will adequately protect consumers and result in lower costs to lenders and lower rates for borrowers.

These reforms, taken together, would in the CMC's opinion go very far towards stamping out the predatory lending practices that are not already illegal on the grounds of fraud.

Comprehensive reform on this scale cannot be accomplished without the enthusiastic support of the federal agencies that will be enforcing the new regulatory scheme. As the agency with the most experience in preemptive nationwide regulatory issues and the greatest familiarity with residential mortgage lending, because of the breadth of the thrift charter and its Parity Act responsibilities, the OTS may be able to see most clearly the revolutionary impact such comprehensive reform can have on the American mortgage industry. With such clear vision, OTS can be invaluable in coordinating the activities of all of the federal banking agencies in maximizing the benefits of this initiative.

### **Additional Practical Steps To Reduce Predatory Lending**

#### *Devote Adequate Resources to Enforcing Existing Laws*

We agree with Federal Reserve Board Chairman Alan Greenspan's recent comments that enforcement of existing laws is the first step that should be taken. Many of the cases cited in the recent news articles were a result of fraudulent practices. Adequate resources at both the federal and state levels of government need to be devoted to pursuing those committing fraud. Therefore, we believe that the appropriate federal and state agencies should advise policymakers

of the resources they need to enforce existing laws so that policymakers can devote the financial resources necessary to combat mortgage fraud.

#### *Nationwide Licensing Network*

We recommend that all mortgage industry participants be licensed, and that a federal system be established to ensure that if a company or individual licensee loses their license in one state as a result of predatory practices, all licenses would be put on regulatory alert nationally. A "Consumer Mortgage Protection Board" would be established to maintain a clearinghouse to identify lenders and mortgage brokers whose licenses have been revoked or suspended in any state.

The goal of this recommendation is to prevent those engaging in predatory practices from being able to move from one jurisdiction to the next, and continuing to prey upon vulnerable consumers while keeping one step ahead of law enforcement authorities in prior jurisdictions.

This new Board could also be responsible for, among other things, reviewing all new and existing Federal regulations and procedures relating to the mortgage origination process and make recommendations that will simplify and streamline the lending process and make the costs of the process more understandable to consumers. The Board could also be used to initiate and oversee public awareness media programs (described below) that will help consumers evaluate the terms of loan products they are considering.

#### *Increasing Public Awareness and Improving Consumer Education*

Consumer advocates have advised industry and government officials that certain consumers, particularly elderly seniors, are not able to clearly understand the loan terms disclosed in the innumerable disclosures provided to consumers during the mortgage process. Streamlining the mortgage process and combining the disclosures to consumers would require changes to existing laws. The absence of any such reform, however, should not deter policymakers from taking non-legislative action to increase public awareness and improve consumer understanding of their loan obligation. We recommend a three-step program:

1. Public Service Campaign. Federal policymakers should implement an ongoing, nationwide public service campaign to advise consumers, but particularly the more vulnerable, that they should seek the advice of an independent third party before signing any loan agreements. Public service announcements could be made on radio and television, and articles and notices could be run in local newspapers and selected publications.
2. Public Awareness Infrastructure. Once alerted, consumers will need to be able to avail themselves of counseling services from unbiased sources. Those sources can always include family and friends and industry participants. In addition, however, a nationwide network should be put in place to ensure that all consumers can easily access advice and counseling to help them determine the loan product that best fits their financial needs. A

public awareness infrastructure could be built out that would include 1-800 numbers with independent counselors, using sophisticated computer software, to help consumers talk through the loan product they are considering. In addition, programs could be developed with community organizations and other organizations serving senior citizens to provide on-site counseling assistance at local senior and community centers.

3. “Good Housekeeping Seal of Approval” for On-Line Mortgage Calculators. The joint Fed-HUD report recommended that the government develop “smart” computer programs to help consumers determine the loan product that best meets their individual needs. Since this idea was first discussed in the federally-sponsored Mortgage Reform Working Group, mortgage calculators or “smart” computer programs have become available online. Since these computer programs were already developed by the private sector and are widely available, a more appropriate role for the government today would be for the federal government to approve a limited and unbiased generic mortgage calculator module that could be incorporated into any online site that helps consumers evaluate various loan products. Legislation may be needed to devote appropriate resources to advance this initiative. However, there may be resources that are available currently in various agencies’ budgets that could be tapped to advance this initiative.

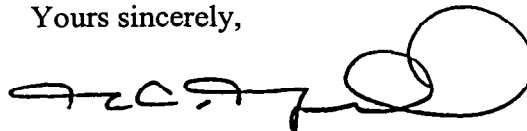
*Use of Existing Federal Regulatory Authority to Stop Abusive Practices*

Regulators may have existing authority to implement changes to existing regulations to prevent loan flipping and other questionable practices. Where such authority exists, agencies should carefully consider whether action should be taken to change existing regulations.

**Conclusion**

With the publication of its ANPR, the OTS has made clear that it is looking for a global solution to the intertwined problems of predatory lending, conflicts between federal and state mortgage regulation, and the enhancement of competitive forces in mortgage lending. It should not limit its search for solutions to a consideration solely of changes to its Parity Act regulations and new regulations applicable only to thrifts and some housing creditors. Instead, the CMC urges the OTS to consider taking the lead in advocating a truly comprehensive solution applicable to all mortgage lenders in the United States.

Yours sincerely,



Anne C. Canfield  
Executive Director