U.S. Consumer Finance

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Household

VIA FACSIMILE (202-906-7755)

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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: Docket # 2000-34, Advance Notice of Proposed Rulemaking ("ANPR") "Responsible Alternative Mortgage Lending"

Dear Sir or Madam:

Thank you for the opportunity to comment at this early stage of your review of regulations implementing the Alternative Mortgage Transactions Parity Act ("AMTPA" or "Parity Act") and the impact of AMTPA on the mortgage market generally.

Background:

Household International, Inc. ("Household"), through its subsidiaries, is one of the largest consumer lenders in the country. Household's lending subsidiaries include Household Bank, f.s.b., several nationally-chartered banks, and a variety of state-licensed lenders. Since 1878, Household Finance Corporation ("HFC"), Household's largest business, has been making loans to a traditionally underserved "middle market" of consumers. While HFC's core business has not changed in over 120 years, this business has come to be known as "subprime" lending. Currently, HFC along with its affiliate, Beneficial Corporation ("Beneficial"), operates over 1400 loan offices in 46 states, where it serves 3.5 million loan customers. HFC and Beneficial lend primarily under state licenses and are thus "housing creditors" for purposes of AMTPA. A majority of HFC loans are real estate secured, and, in a majority of states, a majority of those loans qualify as "alternative" mortgages for purposes of AMTPA.

As loan underwriting technology has developed and laws such as AMTPA have been enacted, companies like Household have been able to lend to a broader customer base, increasing the availability of credit. Most importantly, risk-based pricing and the opportunity to streamline credit products under uniform federal rules can significantly increase the number of borrowers a multistate lender can serve. Other pricing features such as prepayment penalties and late fees can be used to offset a lender's origination and servicing costs for higher risk loans.

Unfortunately, while responsible lenders like Household have been able to use enhanced underwriting capabilities and AMTPA to develop new products to expand credit availability nationwide, there exist certain lenders that engage in unfair practices that harm consumers. Recently, increased scrutiny of the subprime market has focused on these "predatory" lenders. In several states, the result of this focus has been a legislative response. However, as noted by the Office of Thrift Supervision ("OTS") in the ANPR, many of the objectionable practices are already subject to, and often in violation of, a myriad of federal and state laws. Thus, we believe that the appropriate response is not more legislation, regulation, or restriction of responsible lenders, which serves to drive these entities out of the market, but rather a focused enforcement agenda against lenders who violate the existing regulatory and legislative scheme.

Below we have addressed many of the specific questions posed by the ANPR.

1. Should OTS modify its regulations implementing the Alternative Mortgage Transactions Parity Act?

We believe that the current set of OTS regulations designated as applicable to housing creditors under AMTPA is appropriate and carries out the statutory mandate of increased parity with federal thrifts, with an ultimate goal of increased credit availability. However, it is important first to note the extent to which a housing creditor actually gains "parity" by lending under the AMTPA, which will vary from state to state. For instance, in a state where prepayment penalties or late fees on mortgages are prohibited, lending under AMTPA will give the housing creditor the opportunity to charge these fees, provided that it complies with the restrictions contained in the applicable OTS regulations. However, that housing creditor will still remain subject to any restrictions on the interest rate and other items that may apply to the mortgage under state law (which may or may not apply equally to banks and thrifts in that state). In other states where prepayment penalties and late fees may be restricted but not prohibited, a housing creditor will have to determine whether it is more desirable to follow the OTS regulations or local law when deciding to charge the fees. Finally, there are many states where neither prepayment penalties or late fees are restricted, so a housing creditor would likely lend only under state law and not subject itself to the additional OTS requirements. Meanwhile, although AMTPA gives a housing creditor the ability to charge a prepayment penalty or a late fee in a certain state, that lender still will be competing with financial institutions that either may be able to charge higher rates or certain fees under a separate state law, or may not be underwriting criteria regardless of what "market" HFC or its affiliates are lending in. Centralized underwriting facilities help ensure that such consistency is maintained.

- Regarding prepayment penalties and prepaid credit life insurance or loan fees, it is our experience that variations among product features are primarily market driven. Subprime applicants tend not to have significant available funds for closing and thus will only be able to obtain benefits like credit insurance or discount points for a rate reduction with financing. Provided that these products and terms are clearly disclosed and optional, the market should be allowed to drive how and whether they are available.[2] Other loan terms are intended to compensate HFC fairly for services provided and risks associated with the loan. For example, prepayment penalties are priced to compensate HFC fairly for its loan origination costs, and risk-based pricing is structured to compensate HFC fairly for the credit risk it accepts with a particular borrower.[3]

- Under certain circumstances, HFC may appropriately refinance a loan at a rate higher than the rate on the existing balance. In such a case, the full context of such a refinancing should be taken into account. For instance, the Loan-to-Value ratio may be increased significantly by the rewrite because the borrower is taking cash out or consolidating previously unsecured debt; or the borrower's credit profile may have deteriorated since the original loan was underwritten.

- HFC lends both under the Parity Act and under state law. In some states it may do both, depending upon the product offered. Regardless of what legal authority a loan is made under, HFC applies the same policies and ethical standards when offering that product.

2. Should the OTS adopt regulations on high-cost mortgage loans?

While we agree with the results the OTS is trying to achieve, additional regulation of high-cost mortgage loans is unnecessary and could create the unintended result of driving more responsible creditors out of this business in states where housing creditors are relying on the Parity Act. HFC worked closely with the U.S.

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[2] For a more in-depth discussion of the issues related to sales and financing of credit insurance, please refer to the comment letter submitted by our affiliate, Household Insurance Group, Inc.

[3] As described by the Federal Financial Institutions Examination Council ("FFIEC") in its "Interagency Guidance on Subprime Lending" (March 1, 1999): "subprime loans command higher interest rates and loan fees than those offered to standard risk borrowers. These loans can be profitable, provided the price charged by the lender is sufficient to cover higher loan loss rates and overhead costs related to underwriting, servicing, and collecting the loans."

Congress in support of the Home Ownership and Equity Protection Act of 1994 ("HOEPA") and works to ensure that its high cost loans are in compliance with the statute and implementing regulations. The provisions of HOEPA are broad, and include requiring special disclosures; restricting prepayment penalties; and prohibiting default interest rates, balloon payments, negative amortization, prepaid loan payments, and lending without regard to a consumer's repayment ability. HOEPA's provisions apply to all creditors making home loans, including thrifts and housing creditors. While it is true that certain states have recently enacted legislation or regulations that go beyond the comprehensive restrictions contained in HOEPA in an attempt to address predatory practices, the effect of such laws is unknown, particularly their efficacy in preventing predatory lending. Even without these new state restrictions, most examples of predatory loans described in the press or public forums would already violate HOEPA and other existing statutes. At the same time, the vagueness of many provisions of the new state statutes may well discourage responsible lenders from lending under them.

Regarding the more specific questions in this section, we provide the following:

- The OTS notes that "predatory loans are often dependent on the financing of points and fees in the loan, including charges to third parties." As noted above, there are many situations where borrowers at all credit standings may choose to finance fees in a loan that should not be considered predatory. The ability to structure a loan in a manner that suits a borrower should not be arbitrarily limited due to the actions of what the OTS refers to as "unethical" lenders. For example, the ability of borrowers to finance discount points can reduce their overall borrowing costs, even if the monthly payments of those borrowers who choose to finance points will be slightly higher than those of borrowers who choose to pay the points up front. Finally, as previously discussed, an arbitrary limit on financing charges to third parties could restrict a consumer from obtaining desired products like credit insurance which they could otherwise not afford.

- The OTS also asks whether limits on refinancings would be appropriate, and in particular with respect to an institution refinancing its own loans. First, we note that HOEPA already prohibits charging prepayment penalties in a refinancing by the existing lender (or an affiliate). While the practice of loan "flipping" can harm consumers, there should exist the flexibility for consumers who want and/or need to refinance existing debt to do so at the institution where that consumer has an existing relationship. However, as previously discussed, the interest rate on the new loan may be higher. Despite this fact, there may be other economic or less tangible benefits to the consumer. Moreover, for existing customers, many lenders may waive or reduce any penalty or origination fees in the interest of keeping the customer. As a result, a flat prohibition on refinancing at a higher rate would serve only to harm consumers who could easily be driven out of the thrift or finance company where they were accustomed to doing business to a less scrupulous or unfamiliar lender.

- There exists a wide range of mortgage loans priced between "below market rate" and HOEPA restrictions. To eliminate the ability of thrifts and housing creditors lending under AMTPA to charge prepayment penalties on those loans is to force an increase in interest rates, thus restricting credit availability. Prepayment penalties are already restricted on high cost loans as those loans are defined under HOEPA and further regulatory limits are not required. The suggestion that prepayment penalties should only be allowed for "below market rate" loans ignores the economic realities of subprime lending (see footnote 2, supra) while requiring someone to define what a "market" rate is at a particular time, for a particular borrower, for a particular product, in a particular place. As previously discussed, a prepayment penalty compensates lenders for their (possibly significant) origination costs if a loan is refinanced by another lender before those expenses are recouped. If the use of prepayment penalties were unavailable to recoup those expenses, higher rates of interest would be necessary, resulting in a restriction of needed credit for many consumers.

- The ANPR asks "what limits on balloon payments, negative amortization, post-default interest rates, and mandatory arbitration clauses would be appropriate for high cost loans?" While the first three items on this list are sufficiently restricted by HOEPA, we do not believe that mandatory arbitration as a general rule should be limited in any consumer loan contract. Rather, it is our experience that arbitration is a faster, less costly alternative to litigation that can produce results for a consumer that far exceed what they could recoup at the end of a lengthy lawsuit. Moreover, because consumer lending is so closely regulated, arbitrators are generally obligated to apply applicable federal and state law. As a result, provided that an arbitration clause is properly disclosed and fair to the consumer, it is our experience that it is economically effective for both aggrieved consumers and their creditors.

- Specific provisions in the new state predatory lending statutes and suggested by the OTS create particular concern. The suggestion that a lender should determine the "suitability" of a mortgage loan for a particular borrower is inappropriate. Safe and sound underwriting criteria are already a legal requirement for thrifts and a practical requirement for any lender that intends to remain profitable. To layer on this standard a requirement that gives the lender a fiduciary duty to determine what is in the borrower's best interest (in addition to the lender's) is unnecessary, creates a conflict of interest, and will only serve to invite litigation. While it is true that there are less financially-sophisticated borrowers in the marketplace who are receiving high-cost loans, to transfer to all lenders the responsibility for whether any borrower should have taken out a high-cost loan is unwarranted.

- Another provision that certain states have proposed or enacted, and the OTS notes, would require borrowers to either attend credit counseling before closing or at least require lenders to notify them that credit counseling is available. It is our experience that beyond creating additional burdens for consumers and lenders, such requirements, though well-intentioned, can be quite offensive to many customers. Moreover, they can also be difficult to implement, for instance, when there is little state-approved credit counseling available.

3. Is differential regulation appropriate?

The OTS is charged with monitoring the safety and soundness of the thrift industry. Thus, imposing a higher degree of supervision on certain thrifts due to safety and soundness concerns or the thrift's capital rating is within the OTS' statutory mandate. However, we do not believe that simply because such requirements may be necessary for the OTS to fulfill its duties as the supervisor of federally chartered thrifts that there is any reason they should be somehow enforced upon state licensed lenders or other housing creditors. While lenders like HFC are not subject to a regulatory scheme that monitors such items as capital levels or underwriting criteria, they are subject to market regulation. In order to obtain funds to profitably lend to its customers, HFC must maintain specific debt ratings and the confidence of outside investors and creditors. Such ratings are based on HFC's capital, its income and loan losses, as well as other financial indicators. As has been clearly demonstrated in recent years, a subprime lender's loss of funding will shut it down quickly and completely.

As an added note, simply because the AMTPA aims for "parity," federal thrifts in many regards still have powers not enjoyed by state-licensed housing creditors lending under the AMTPA. For example, HFC's California subsidiaries may be competing in that state with thrifts exporting more profitable rates and terms from Oregon or Utah. While those out-of-state thrifts may have to meet certain OTS requirements to offer certain products, this is no reason to add to the burden of a housing creditor that may already be lending at a disadvantage.

4. How should OTS deal with potential lending issues raised by thrift subsidiaries or affiliates?

As noted by the OTS, subsidiaries of thrifts are subject to the same laws and regulations, OTS examination and supervision as their affiliated thrifts. Therefore, issues raised by the activities of subsidiaries are the same as, and should be treated no differently than, issues raised by activities of the parent thrift. Household's thrift engages in a significant amount of lending operations in connection with its affiliate, HFC, and we believe that this occurs without jeopardizing the safety and soundness of that institution or harming consumers. However, we understand that there could be affiliates of other thrifts that could threaten either the safety and soundness of those thrifts or their compliance with consumer laws and regulations. That being said, it is likely that "one size fits all" regulations that contain arbitrary limits on a particular type of lending would benefit neither the majority of thrifts and their affiliates that are operating safely and soundly in compliance with consumer protection regulations, nor the outliers which are not. The OTS has many avenues with which to address unsafe and unsound practices and violations of law, particularly with respect to those thrifts that have fallen into lower capital or compliance categories. Those thrifts that can operate safely and soundly in connection with their subprime subsidiaries and affiliates should be allowed to do so. Particularly with respect to thrift subsidiaries, this would allow subprime lending to take place in an environment that is closely supervised and regulated – a theme that OTS casts in a positive light throughout the ANPR. On the other hand, where appropriate, OTS could apply more rigorous capital or compliance standards to thrifts whose relationship with subprime affiliates is perceived to create an unsafe or unsound condition.

5. Should the OTS impose certain due diligence requirements?

The due diligence practices described by the ANPR (reviewing loan files to determine whether they meet federal and state legal requirements) represent safe and sound banking practices. If there are purchasers who do not conduct such due diligence, it is highly uncertain whether additional regulation will force them to do so. Once again, this is an area that should be enforced against thrifts that are not acting in a safe and sound manner. However, any such due diligence requirement should take into account its practical implications. Many mortgage sales and most mortgage-backed securities involve thousands of loans. Due diligence by necessity involves a statistical sampling. It is impractical to expect that investors will review all files for each pool for general legal compliance. Frequent issuers of mortgage-backed securities or sellers into the secondary market generally will receive a more thorough compliance and practices examination when initially selling loans, and periodically will again be reviewed. However, a requirement that these more extensive examinations be conducted for all sales would inhibit an efficient funding market and place an unreasonable burden on the larger, more established and frequent sellers of mortgages.

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We appreciate this opportunity to comment on the Advanced Notice of Proposed Rulemaking. At Household, we agree that action needs to be taken to control abusive lending practices. However, at a time when more credit is available to more people than ever, the regulatory challenge is to avoid limiting competition, consumer choice, and the availability of credit to the people who may need it most. The Parity Act has enabled the creation of new loan products and pricing structures that have increased the availability of mortgage credit. We now urge the OTS to act cautiously before restricting this legal authority that provides a source of credit for millions of consumers.

If you should have any questions regarding this letter, please feel free to contact Martha Pampel at (847) 564-7941.

Sincerely,

Gary D. Gilmer
Group Executive
Household International, Inc.

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