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State of New Jersey
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF BANKING
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July 3, 2000

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

RE: Responsible Alternative Mortgage Lending; Advance Notice of Proposed Rulemaking (65 FR 15526)

Dear Sir or Madam:

The New Jersey Department of Banking and Insurance (the Department) is pleased to have the opportunity to comment on the advance notice of proposed rulemaking (ANPR) regarding responsible alternative mortgage lending published by the Office of Thrift Supervision (OTS). We are pleased to note that, as part of the ANPR, the OTS is reviewing its mortgage lending regulations to determine their effect not only on federal savings associations and their customers but also on state-licensed housing creditors who make alternative mortgage transactions under the Alternative Mortgage Transactions Parity Act (AMTPA) and their customers.¹

The Changing Financial Services Environment

The ANPR is concerned mainly with the effects of the Alternative Mortgage Transaction Parity Act (AMTPA) so the Department's comments will naturally focus on those issues. However, in order to set the proper context for those comments, it is important to recognize that AMTPA is only one of a series of federal laws that through preemption have eroded state authority to prevent predatory practices.

The Rise of Non-Conventional Mortgage Loans

AMTPA was enacted in 1982, when adjustable rate mortgages were a somewhat unusual product and were not permitted in a number of states. AMTPA was passed to allow state housing creditors to offer non-traditional mortgage loans, irrespective of state

¹ 65 Fed. Reg. 15526 (March 23, 2000).

laws governing mortgage lending. At the time of passage, the risks to the public were limited, given that only a small part of the mortgage lending market was comprised of loans meeting the definition of "alternative mortgage loan" under AMTPA.

At present, alternative mortgage loans are a major mainstream mortgage loan product rather than a somewhat exotic minor product. Indeed, they have become more popular precisely because, by structuring the loan in terms of the statute, the lender is exempt from many consumer-protective restrictions. Rather than allowing the market to work in offering these loans, AMTPA has created a market for a new type of loan by tying it to a preemption from state consumer protection laws.

The Over-Reaching Scope: Preemption for Unregulated Entities

The impact of the definition of "housing creditor" under AMTPA has widened steadily since the passage of the act because there has been a significant shift in who makes mortgage loans. Most of those who are able to take advantage of the definition are non-depository lenders, such as mortgage bankers under New Jersey's Licensed Lenders Act (N.J.S.A. 17:11C-1 et seq.) In 1980, 72% of mortgage loans were made by depositories and only 22% by non-depository mortgage lenders. By 1997, the latest year of available data, the percentage of mortgage loans made by depositories had dropped to 43% (with almost all of the market-loss being by thrifts rather than commercial banks), while the percentage of loans made by licensed lenders rose to 56%. Thus, presently, more than half of all mortgage loans are originated by non-depository lenders. Thus the preemption offered by AMTPA applied to the part of the industry that gained a significant market share in the years following enactment. Its consequences have been expanding over the years and were, to a large extent, as the ANPR noted, "unforeseen". While the vast majority of these non-depository lenders are viewed as good corporate citizens and treat consumers fairly, our experience has been that the lenders most likely to engage in predatory practices are generally found in this group of lenders. It is these few "bad apples" who are most likely to unfairly use the alternate mortgage transaction designation to circumvent state consumer protection laws governing mortgage transactions.

The way that preemption was applied in AMTPA also raises a serious issue of scope. By this, I include not only the range of state laws that were rendered inapplicable, but also, the fact that AMTPA preempts state law for all housing creditors that qualify under the broad definition in the act. In New Jersey, most of these housing creditors are state licensees that are not otherwise subject to regulation by the Office of Thrift Supervision. Yet, if these entities can meet the broad definition of housing creditor in AMTPA, they are exempt, even though they have no other connection to OTS. It is one thing to preempt state law for entities directly regulated by a federal agency, but it is quite another thing for it to preempt the application of state law for entities that no federal agency regulates directly.

The Traditional Sphere of State Regulatory Authority and Concern

The impact of AMTPA (and other preemptive federal laws) has hit the states particularly hard because the regulation of non-depository lending has traditionally been the province of the states. Various states have reached different public policy conclusions on how they wish to protect consumers in their justifications. Thirty-seven

state legislatures require that non-depository mortgage lending must be licensed. In addition, there are a variety of other consumer protection laws that the states have passed in order to ameliorate the harshest effects of an untrammled market.

The Limitations of the OTS's Free Market Approach

The ANPR correctly states that the OTS has adopted a market approach. The Department notes that this is precisely the approach that gave rise to the consumer protection laws in the first place. Thus, the OTS policy represents, on one level, a step backward in time, back to the place where the states were before they passed consumer protection laws.

In many respects, it would have been preferable if the federal government had established a national standard embodied in regulation, as it has done in real estate closings, truth in lending, etc. There are relatively few complaints from the states on these laws. However, AMTPA preempted state consumer protection laws relative to mortgage lending without OTS creating a body of federal consumer protection laws to replace them. The body of OTS regulations that now "regulate" alternative mortgage transactions is limited indeed. (We recognize that this is, however, completely consistent with OTS policy of allowing the market to operate.) The result, as we now know, is that in many instances the consumer is left with virtually no protections and has, in a number of locales, suffered from predatory financial practices.

The Proper Sphere of State Regulation in an Interstate Environment

The Department recognizes that preemption has a proper place in the federal scheme. We also recognize that financial institutions that conduct business across state lines need a degree of uniformity. However, allowing uniform competition everywhere should not be allowed to become a vehicle for legitimizing predatory financial practices. The states should be given some latitude to enact laws protecting their residents against market-driven lending practices, at least after a certain point. The responses will vary from state to state as they respond to local market conditions and local sensitivities regarding the consumer protections that are needed. This is as it should be as the states exercise their traditional province of the states in this area.

We do not suggest that the scope of state authority should be unlimited. If AMTPA had preempted states laws that were merely "fine-tuning", we would have no objection. It is quite another matter, however, to preempt, without limit, state laws protecting consumers. It is not enough, in response, to say that the market should be allowed to work, because the consumer-protective laws were passed in the first place in order to address problems that arose from the free operation of the market. We have been there twice now, and know its effects well.

Specific New Jersey Laws Preempted by AMTPA Laws

In New Jersey, interpretations of preemption by federal agencies have preempted our Licensed Lenders Act (N.J.S.A. 17:11C-1 et seq.) and our Mortgage Processing Regulations (N.J.A.C. 3:1-16.1). Both of these bodies of law contain reasonable provisions designed to protect our consumers while letting the market operate in a reasonably free manner. They contain provisions requiring bonding, net worth, liquidity,

reporting, being subject to examination, timing of collection of fees, and the categories of fees that may be collected.

The Need for Proper Process When Preempting

The Department is not only concerned about the wide sweep of preemption, but also, about the process by which preemption is accomplished. Commonly, preemption is effected by an opinion letter from the agency that a particular state law is preempted. The letter, usually signed by a single non-elected government official, has the effect of overturning the deliberations and policy judgments of the Legislatures and Governors of the various states, who have been elected precisely to take appropriate actions about such issues facing their constituents.

At a minimum, what is needed going forward, is a process in which decisions to preempt are published, comment is received and those comments are taken into consideration when the federal agency makes its final decision. Given the sweeping preemptive effect of federal action in this area, shouldn't the states and the public be accorded the same opportunity of notice and comment that is required in connection with the promulgation of a regulation?

Conclusion

Congress passed the AMTPA and other preemptive bills in an earlier, simpler financial services environment. Today's environment is quite different. We are pleased that OTS is reviewing the effects of its preemptions on businesses and on consumers. In the light of the experience that we have all gained since the passage of AMTPA, we recommend that OTS establish a reasonable national standard for lending that takes into account the abuses of predatory lending. Clearly, these are behaviors that do not need to be protected in any sense. The Department also recommends that OTS provide the states latitude in curbing the abuses after they reach a certain level.

Thank you for your consideration of these comments.

Sincerely,



Nicholas J. Ketcha Jr.
Director

NJK:bw

G:waits:otsltr