



# Vermont . . .

Department of Banking, Insurance,  
Securities and Health Care Administration

Consumer Complaints/Assistance only:  
Insurance: 1-800-964-1784  
Health Care Administration: 1-800-631-7788  
See other division numbers below.

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July 5, 2000

Ms. Ellen Seidman  
Director  
c/o Manager  
Dissemination Branch  
Information Management & Services Division  
Office of Thrift Supervision  
1700 G Street, N.W.  
Washington, D.C. 20552

**Re: Responsible Alternative Mortgage Lending ANPR**

Dear Ms. Seidman:

You have indicated that your agency is reviewing its mortgage lending regulations to determine their effect in today's market on the customers of state regulated housing creditors who may be making alternative mortgages under the Alternative Mortgage Transactions Parity Act.

The Vermont Department of Banking, Insurance, Securities & Health Care Administration is charged with promoting and maintaining the safety and soundness of financial institutions doing business in Vermont and protecting the public against unfair and unconscionable lending policies. It is the second half of our legislated mission, consumer protection, that sets us apart from many other financial institution regulatory agencies.

In 1998 the Vermont legislature adopted two statutes pursuant to which this Department promulgated two regulations designed to protect borrowers from predatory lending practices. Those regulations require lenders to supply their borrowers with basic minimum loan information. Regulation B-98-1, Form, Content & Timing Of Residential Real Estate Mortgage Loan Commitment Letters, requires that at least 24 hours prior to closing, the lender provide the borrower with a commitment letter which clearly states the terms of the loan, as well as the borrowers monthly payment. With this information in hand, a borrower can accurately determine whether or not they can actually afford to make the monthly payments required under the loan being offered. Regulation B-98-2, High Rate, High Point Notices For Residential Real Estate Loans, requires lenders charging in excess of 4 points, and/or charging an interest rate in excess of an annually statutorily set rate, to merely provide borrowers with a notice informing the borrowers that they can obtain information regarding alternative lending sources from this Department. It is the Department's position that the more information a borrower has to make a decision, the less likely that borrower will fall victim to predatory lending practices.

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However, immediately following the adoption of these regulations, the Department received a number of letters from housing creditors licensed in Vermont, informing the Department that they were "opting out" of these state regulations, as permitted by the Parity Act. While it is true that the Parity Act does not grant housing creditors the same powers as federal savings associations, but merely permits them to follow Office of Thrift Supervision ("OTS") regulations when making alternative mortgage loans, given the OTS' ever expanding definition of "alternative mortgage transactions" and lenders' innovative approaches to an ever changing mortgage lending market, it appears that more and more types of loans will be classified as "alternative" by the OTS.

In 1982, Vermont had only seven "licensed lenders" and did not provide for non-bank entities to make residential mortgage loans. At that time the Vermont legislature did not foresee the proliferation of non-bank mortgage lenders and as a result did not opt out of the Parity Act. Neither could the Vermont Legislature have foreseen the vast expansion of HOLA, originally adopted to encourage homeownership, into the area of special purpose trusts banks, unitary thrifts, and the sanctioning of an insurance company owned bank which conceivably could have over 16,000 "branches" throughout the country. Today Vermont has over 400 licensed "housing creditors." Although these entities are licensed by this Department, and engage in the business of making residential mortgage loans in this state, as a result of the Parity Act and the OTS' liberal interpretation of "alternative mortgages," these entities believe they are free to make mortgage loans in Vermont without regard to a number of Vermont consumer protection laws and regulations.

For example, Vermont law prohibits prepayment penalties on residential mortgage loans. Yet a lender can entice an "at risk borrower" with a "blemished" credit history, to consolidate short term unsecured debt into long term debt secured by the borrower's home. The pitch to the consumer is to consolidate debt and get a year or two "track record" and then refinance with a conventional lender. However, in contravention of Vermont law, there may be a stiff prepayment penalty for any refinancing occurring during the first five years of the loan. Such prepayment penalties effectively prevent the borrower from refinancing the loan.

Additionally, some of these contracts specify that if the loan is foreclosed during the first few years of the loan, the prepayment penalty is still triggered. Borrowers agree to these terms because they are in dire circumstances and/or are financially unsophisticated, and may not fully comprehend the consequences of such provisions. Often these loans have high rates and high points, and under Vermont law would trigger the High Rate, High Point Notice discussed above as well as the issuance of a commitment letter in advance of closing. Contrary to OTS assertions, a prepayment penalty in the subprime market does not usually translate into lower interest rates, but is merely another revenue vehicle for predatory lenders. It is these lenders who are clearly taking advantage of their borrowers' lack of bargaining power that cite OTS regulations and claim preemption over Vermont state consumer protection laws.

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The Department is currently investigating a complaint from a couple regarding a problem they are having with their refinanced loan. In July 1999 they called a national lender in response to an advertisement they heard and asked about getting financial help. The lender told them it could help, but it would have to be done in two parts. First, the borrowers would have to refinance their mortgage with the new lender. Once the existing \$50,421 mortgage loan was refinanced, the lender would then give them a home equity loan for the money they needed. The refinanced loan was in the amount of \$54,400 with an interest rate of 10.450% which was fixed for 3 years and then adjustable every six months after that, with an interest rate cap of 16.450% and a floor of 10.450%. Once adjustable, the rate could go up as much as 1% every six months. Additionally, the loan included a prepayment penalty that would require the borrowers to pay the equivalent of 6 months interest if they chose to prepay the loan anytime during the first five years. After the first mortgage was in place, the lender told the borrower, that based on their credit report they didn't qualify for the home equity loan. Making matters more egregious is the fact that the borrowers original mortgage loan had a fixed interest rate of only 7.450%, with no prepayment penalty, and a monthly payment \$124 less than the new mortgage loan. Effectively, these borrowers paid \$2,186 in closing costs for the benefit of paying off a \$1,793 credit card balance, the privilege of increasing their interest rate by at least 3%, and opportunity to pay a prepayment penalty if they chose to refinance their new loan within five years. Our preliminary findings indicate the lender failed to provide a commitment letter prior to closing, in violation of Vermont law, in addition to referencing the Parity Act as the basis for including a prepayment penalty.

The average Vermont borrower is not aware of the Parity Act and its preemptive affect allowing Vermont licensed entities to follow the rules of a federal regulator charged with assuring the safety and soundness of federal thrifts, not the protection of Vermont consumers. Vermont borrowers assume that if a lender is licensed by Vermont, then they are protected by the laws of Vermont. When lenders are free to ignore state disclosure and consumer protection requirements, it is the more vulnerable subprime borrower who is most at risk.

Given the drastic change in the residential mortgage market, borrower profile, and the ever expanding activities of OTS regulated entities, this Department believes that the application of the Parity Act should be limited solely to OTS chartered entities. States should have the power to regulate the entities licensed by that state. States should have the power to protect their consumers from unfair and unconscionable lending practices.

Sincerely,



Elizabeth R. Costle  
Commissioner