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To Whom It May Concern:

On behalf of the National Community Reinvestment Coalition, the nation's CRA and fair lending trade association of over 700 community-based organizations and local public agencies, I am writing to provide NCRC's views on the Office of Thrift Supervision's Advanced Notice of Proposed Rulemaking (ANPR) regarding responsible alternative mortgage lending. NCRC appreciates the opportunity to comment on this critically important issue.

As a nationwide coalition concerned with fair lending and fair access to credit, NCRC and its members have worked tirelessly to increase lending to minority and working class communities over the last decade. Recently, however, traditionally underserved communities have increasingly been victimized by a surge of "predatory lending," or the extraction of inordinate fees and interest rates from unsuspecting clients in exchange for little or no financial service. As a result, thousands of low- and moderate-income Americans nationwide have had their dream of homeownership turned into a nightmare. Often, the targets of these predatory lending schemes are the elderly, low-income, and financially illiterate citizens; those who can least afford such financial turmoil, and who are easily made homeless by these practices. The rise in predatory lending threatens to destroy many of the gains that low- and moderate-income and minority communities have realized in the last several years.

No individual or family should be subject to such unscrupulous and abusive practices, and NCRC believes the OTS should comprehensively revise its regulations to ensure that they, as Director Seidman has said, "actively discourage, rather than inadvertently allow, predatory practices." As part of such revisions, the OTS must not only modify



its regulations implementing the Alternative Mortgage Transactions Parity Act, but also adopt strong regulations on all high-cost mortgage loans. Only by doing so will the OTS help prevent lending practices that are solely intended to deceive and dispossess low- and moderate-income, elderly, and minority borrowers of their property and wealth.

Below, NCRC addresses the major issues raised by the ANPR.

Problems with the Alternative Mortgage Transactions Parity Act (the Parity Act)

NCRC agrees with Director Seidman's April 5, 2000 assessment in *American Banker* newspaper that the Parity Act is "no longer a recipe for effective supervision" and "may have outlived its usefulness."¹ The Director has indicated that the agency will actively support Congressional repeal of this law, something NCRC supports as well. However, given the unlikelihood of Congressional repeal in the near term, the OTS must take affirmative steps to ensure that irresponsible state housing creditors are not allowed to continue to use the Parity Act to skirt state laws protecting consumers and communities from predatory practices.

The Parity Act was enacted in the early 1980s when interest rates were high; in order to encourage variable rate mortgages and other "alternative" financing vehicles to stimulate credit. In supporting the Parity Act when passed, mortgage bankers argued that overly restrictive state laws prevented state-chartered housing creditors from originating such alternative mortgage loans. At the time, the secondary market was less developed, and lenders had to hold fixed-rate, fixed term mortgages in their portfolios, creating asset-liability mismatches between long-term mortgages and short-term deposits. While the Parity Act was perhaps necessary in this environment, the environment has now changed significantly.

Today, institutions can much more easily manage their asset-liability problems through a more sophisticated secondary market. In addition, state housing regulators now regularly allow alternative mortgage transactions. At the same time, there has been an explosion of subprime lending, with abusive and predatory practices particularly prevalent among

¹ See April 5, 2000, *American Banker*, "Moving Against Predators. OTS Takes Aim at Loophole," by Kevin Guerrero.



non-depository, independent mortgage companies. These same companies are using the Parity Act to structure their loans as alternative mortgages in order to preempt state protections against unfair, deceptive, and unscrupulous practices.

Cases have arisen across the country in which, for instance, nonfederally chartered subprime home equity lenders have used the Parity Act to structure their loan transactions to evade state laws limiting such things as prepayment penalties and other fees and charges, and the courts have upheld these actions. A recent example of this can be found in the State of Virginia, where the National Home Equity Mortgage Association, or NHEMA, successfully sued to prevent the State from enforcing its statutes limiting prepayment penalties for alternative mortgage transactions. The federal district court found that Virginia's statutes were preempted by the Parity Act and that NHEMA has standing to bring its lawsuit alleging such.

According to testimony given before the House Committee on Banking and Financial Services on May 24, 2000, the Conference of State Bank Supervisors (CSBS) reported that the Parity Act "has made it difficult for states to offer the protection that consumers demand" and "often stands in the way of states enforcing its own laws and thus cracking down on predatory lenders." Research done by both the General Accounting Office and the CSBS documents that state housing creditors have used the Parity Act to bypass an assortment of state mortgage lending laws across the country including not only prohibitions on prepayment penalties, but also limitations on up-front fees for home equity loans, limitations on late charges, prohibitions on negative amortization, disclosures for high-rate, high-point mortgage loans, limitations on appraisal fees for home mortgages, and prohibitions on balloon mortgages.²

While the Parity Act was not meant to be a refuge for predatory lenders, it is clearly being utilized as such, as the GAO and CSBS document.

² See both General Accounting Office, Report to the Honorable James Leach, Chairman, Committee on Banking and Financial Services, House of Representatives, Role of the Office of Thrift Supervision and Office of Comptroller of the Currency in the Preemption of State Law, February 7, 2000, and Testimony of Thomas J. Curry, Commissioner of Banks, Commonwealth of Massachusetts, on behalf of the Conference of State Bank Supervisors, Before the Committee on Banking and Financial Services, United States House of Representatives, May 24, 2000.

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Involvement of OTS-Regulated Institutions in the Subprime Market³

However, it is not just state housing creditors operating under AMPTA that have been increasingly involved in subprime and potentially predatory activity. According to the recently released HUD/Treasury report on predatory lending, between 1993 and 1998, the number of subprime mortgage loans (home purchase and refinance) originated by banks and thrifts increased by 551 percent while the number of such loans originated by affiliates of banks and thrifts increased nearly 70-fold. In total, about 25 percent of all subprime mortgages were made by depository institutions and their affiliates in 1998.⁴ Obviously, this is a significant percentage of regulated depository institutions, highlighting the need for stronger oversight on the part of all Federal banking agencies.

Among OTS-regulated institutions in 1998, about 75,000 conventional home purchase and refinance loans, or 4 percent of all such loans made by these institutions, were subprime according to NCRC's analysis using HMDAWare™, produced by CLC Compliance Technologies, Inc. Black borrowers were four times more likely to receive subprime rather than prime refinance loans, and about three times more likely to receive subprime rather than prime home purchase loans from OTS-regulated institutions. While African Americans received about 2.5 percent of all prime refinance loans in 1998 from OTS-regulated institutions, they received nearly 10 percent of all subprime refinance loans from these institutions. Similarly, while blacks received 3.5 percent of all prime home purchase loans in 1998 from OTS-regulated institutions, they received about 9 percent of all subprime home purchase loans made by these institutions. For white borrowers, these patterns reversed themselves, with whites more likely to receive prime rather than subprime loans from OTS-regulated institutions in 1998.

NCRC would like to point out some of the specific and questionable practices in which OTS-regulated subprime lenders are engaged, and the limited oversight these practices have received from the OTS.

³ A full list of OTS-regulated subprime lenders is attached, excerpted from Randall M. Schuessle, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999.

⁴ See Curbing Predatory Home Mortgage Lending, a Report by the U.S. Department of Housing and Urban Development and the Department of the Treasury, June 2000.

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Superior Bank, FSB

Based in Oakbrook Terrace, Illinois, Superior Bank, FSB is a major thrift and subprime lending institution. The OTS CRA exam of September 1999 reports that this institution of \$1.8 billion in assets made or purchased more than 39,000 home loans from January of 1997 through July of 1999. The exam states that Superior has "flexible underwriting guidelines, which benefit low- and moderate-income persons and families." It adds that "Superior's lending business focuses on lending to "A-," "B", or "C" borrowers, who are borrowers that have varying degrees of credit history problems."

NCRC decided to investigate Superior's lending practices further to see if their "flexible" underwriting standards truly benefited minorities and low- and moderate-income borrowers. When we went to Superior's web page, we found a sales-pitch for those with less perfect credit. The pitch says, "Contrary to popular belief, good credit does not necessarily mean perfect credit. If your credit reports show any 60 to 90 day late payments, you may need to seek out a lender that specializes in less than perfect credit – like **Superior Bank** (bold highlight on its Internet site)." NCRC believes that at best, this sales pitch is on the edge of propriety. One late payment of 60 days does not automatically qualify someone for a subprime loan; hence Superior uses the word "may." But the unsuspecting consumer may feel that he or she may have no choice but to apply at Superior after reading this.

On the Edgar database of the Securities and Exchange Commission, NCRC found a Superior prospectus dated August 9, 1999 which indicates that Superior's loans may be better deals for investors than consumers, in contrast to Superior's cheery Internet advertising. In the prospectus, Superior advises investors purchasing their loans, "In particular, it is possible that some mortgage loans included in a trust fund will be subject to the Home Ownership and Equity Protection Act of 1994...Recently, class action lawsuits under the Homeownership Act have been brought naming as a defendant securitization trusts such as the issuer with respect to the mortgage loans."

Superior continues, "The seller will represent that all applicable federal and state laws were complied with in connection with the origination of the mortgage loans. If there is a material and adverse breach of a representation, the seller will be obligated to repurchase any affected mortgage loan or to substitute a new mortgage loan into the related trust fund."

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Reading the prospectus further, NCRC wondered if Superior built in as many protections for the borrowers of their loans as for their investors. Superior was selling 3,224 loans worth \$202 million dollars in a bunch called "Group 1." Superior's prospectus states that 25.2 percent of Group 1's loans were balloon loans. On a national level, according to the recent HUD/Treasury Task Force report on subprime lending, 10 percent of all subprime loans had a balloon payment. Superior's Group 1 loans are 2.5 times more likely to have a balloon payment than all subprime lending in the country during 1999.

Since such a high percentage of Superior's loans have balloon payments, the next question is will borrowers have problems paying off the loans before the balloon date. High interest rate loans with balloon payments are especially problematic. According to Superior's interest rate chart, 2,174 loans or 67 percent of the loans in Group 1 had interest rates above 10 percent (or four percentage points above the 6 percent rate of Treasury securities during 1999). More than 800 of the Group 1 loans or 25 percent had rates above 12 percent. Current HOEPA protections would apply to only one loan that had an interest rate above 16 percent (10 percentage points above the Treasury rate).

NCRC has recommended that the HOEPA interest rate threshold be four percentage points above the Treasury rate. This would extend HOEPA protections to 67 percent of Superior's Group 1 loans. The HUD-Treasury report recommends lowering the HOEPA threshold to 6 percentage points above the Treasury rate. This would extend the HOEPA protections to 25 percent of Group 1 loans. Among other protections, HOEPA prohibits balloon payments during the first five years of the loan. Extending HOEPA is necessary generally and in this case, given the high incidence of balloon payments in Superior's Group 1 loans.

In the prospectus, Superior was also selling 1,402 loans it called Group 2. Superior had a minimum and a maximum interest rate scenario for Group 2. Under the minimum rate scenario, 46 percent of their loans had interest rates above 10 percent and another 2.4 percent had interest rates above 12 percent. Under the maximum rate scenario, all the loans had rates above 12 percent, and 78 percent had rates above 16 percent.

After reading the prospectus, the CRA exam raised even more alarm bells. It describes a "Universal Mortgage Product" in the following paragraph:

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The Universal Mortgage Product is designed specifically to improve a borrower's day to day cash flow by consolidating their various debts and lowering their combined payment and overall cost of credit. Under this program, the first payment is deferred and forgiven if the loan is maintained for five years. The borrower is provided 26 payment reduction vouchers at closing to use at any time during the term of the loan (when used, deferred payments are not required to be paid at maturity). Overall amount of interest paid is reduced since payments are due every 28 days rather than monthly. No private mortgage insurance is required and all closing costs may be included in loan amount rather than paid at closing. If the borrower needs additional funds after consummation, any principal amount previously paid down on current mortgage can be borrowed without any additional closing fees and as long as the borrower meets certain criteria, he (or she) may change the payment amount (to as low as interest only payments) at anytime throughout the loan term. This product does not require tax or insurance escrow payments.

The examiner accepts at face value that these terms are flexible and beneficial for low- and moderate-income borrowers. The payment reduction vouchers and the feature of paying the loan every 28 days may indeed look like bargains. The other loan features, however, give pause for concern. Since all closing costs can be financed, what percentage of the loan amount are fees that are financed? In addition, the borrower can borrow against principal already paid. But does Superior provide borrowers with advice about possible negative amortization and prolonged indebtedness. Also, the Universal Mortgage Product does not require tax or escrow payments. But does Superior explain to the borrower that tax payments are still required to be made outside of the loan payments?

Superior's Universal Mortgage product appears to be appropriately named. In 1998, Superior made 16 percent of its 15,338 refinance and home purchase loans to Blacks while OTS-regulated subprime lenders made nearly 10 percent of their loans to Blacks and OTS-regulated prime lenders made about 2.5 percent of their loans to Blacks. Likewise, Superior made 37 percent of its single-family loans to low- and moderate-income borrowers while OTS-regulated subprime lenders made 22 percent and OTS-regulated prime lenders made 23 percent.



While Superior's mortgages may have been universally available (or at least more so than other OTS-regulated institutions), the OTS did not probe in its CRA exam if Superior's loan terms were universally advantageous. NCRC believes that CRA exams and the accompanying fair lending reviews must rigorously examine loan term and conditions. The CRA exams must include full-fledged discussion about compliance with fair lending laws, particularly in cases of subprime lenders like Superior.

Downey Savings and Loan Association, FA

Downey Savings and Loan is a major lending institution based in Newport Beach, California. From September of 1997 through September of 1999, the thrift made 32,950 home loans according to an OTS CRA exam dated December of 1999. The exam notes that about 18 percent of Downey's loans in 1999 were subprime.

Downey makes loans that exhibit negative amortization. According to its 10-K statement of March 7, 2000, Downey limits the amount of negative amortization because "if a loan incurs significant negative amortization, then there is an increased risk that the market value of the underlying collateral on the loan would be insufficient to satisfy fully the outstanding principal and interest." Accordingly, Downey states that it imposes a limit on the amount of negative amortization so that the principal and interest does not exceed: 1) 125 percent of the original loan on loans having a loan-to-value ratio of 80 percent or less, 2) 110 percent on loans having a loan-to-value ratio over 80 percent.

The 10-K statement implies that Downey is limiting negative amortization in part in order to be able to recover losses in the event of foreclosures. The thrift states that too much negative amortization runs the risk that the outstanding loan amount would exceed the value of the house, meaning that Downey could not recover the full loan amount if it sold the house.

Additional data in a July 19, 1999 prospectus statement suggests that Downey is hedging its bets. The prospectus statement states that subprime loans have a higher rate of delinquencies than prime loans. It then lists 4,379 non-performing subprime loans as of March 31, 1999. This could amount to a high percentage of the 32,000 loans that Downey made from 1997 through 1999.

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HOEPA prohibits high cost loans from exhibiting negative amortization. Downey's CRA exam and its accompanying fair lending review did not publicly discuss loan terms and conditions. Two sentences in the exam note that Downey did not violate the Fair Housing Act or the Equal Credit Opportunity Act in any substantive manner. This bare bones discussion of fair lending issues leaves the reader wondering if the OTS scrutinized the appropriateness and the safety and soundness of Downey's subprime loans issued to minorities and low- and moderate-income borrowers.

Ocwen Federal Bank, FSB

Ocwen Federal Bank, FSB received a satisfactory rating from the OTS on its last CRA performance evaluation in 1999. Although the institution is engaged, as the OTS itself notes, "primarily in the business of wholesale purchases of non-performing or sub-performing single family and commercial mortgage loans," (which account for 72 percent of the number and 70 percent of the dollar volume of loans made during the institution's exam period), the OTS failed to include an examination of these loans in its CRA exam, or the way in which Ocwen "uses a variety of collection strategies to return these loans to performing status." A substantial number of these loans probably end up in foreclosure since Ocwen maintains an online auction of foreclosed homes nationwide on its Internet site.

Ocwen is also a nationwide lender which originates single family subprime mortgages through a network of approximately 2000 mortgage bankers and brokers. While the OTS's CRA exam does make comparisons with other nationwide subprime originators and their activity in low-and moderate-income areas, it again says nothing about the terms and conditions of these loans. The OTS exam also fails to address the way in which these subprime loans are marketed and the procedures that Ocwen uses to ensure that prime credit candidates are not steered to subprime products offered by Ocwen.

Recommendations for Strong OTS Anti-Predatory Lending Regulations and Increased Scrutiny of Subprime Lenders

In order to rectify these problems, NCRC believes that the OTS should use its authority to not only adopt comprehensive anti-predatory lending regulations governing all OTS-



regulated thrifts, but also apply this regulatory framework to state housing creditors that wish to utilize the Parity Act's preemption of state law for alternative mortgage transactions. In addition, the OTS needs to step up its scrutiny of subprime lending during CRA exams and accompanying fair lending reviews.

As states such as North Carolina and New York, Members of Congress, as well as the OTS, have recognized, the Home Ownership and Equity Protection Act (HOEPA) as currently written falls far short in fully protecting vulnerable borrowers from predatory lenders. To begin with, the law's triggers for what constitutes a high-cost loan—which provide greater consumer protections—are set much too high at an annual percentage rate of 10% above current Treasury bill rates, or with total points and fees exceeding 8% of the loan amount. Also, HOEPA does not severely limit or prohibit certain lending practices that are clearly abusive and indicators of predatory tactics, including prepayment penalties, the financing of sizable points and fees, loan flipping, the up-front collection of single-premium credit insurance, encouragement of default, mandatory arbitration, negative amortization, and arbitrary call provisions.

NCRC believes that the OTS needs to address these problems. OTS should use its authority to define high-cost loans as those with an annual percentage rate of 4-5% above current Treasury bill rates, or with points and fees greater than 3-4% of the loan amount. The definition of points and fees should include all the costs the borrower is required to pay in order to get the loan.

In addition, the OTS should prohibit prepayment penalties, balloon payments, frequent refinancing or "flipping" of loans with no benefit to the borrower, encouragement of default by the lender, negative amortization, and arbitrary call provisions in all high-cost loan transactions. The OTS should also prevent the financing of single-premium credit insurance and mandatory arbitration for all mortgage loans, while requiring homeownership and foreclosure prevention counseling on high-cost loans prior to closing and foreclosure proceedings, respectively. This counseling should be done by a loan counseling agency that is independent from the lender and approved by the OTS.

These regulations should apply to all thrifts the OTS oversees, and state housing creditors wishing to utilize the Parity Act to preempt state law.



As the previous examples show, the OTS also needs to increase its scrutiny of subprime lending during CRA exams and accompanying fair lending reviews. CRA has been instrumental in leveraging a tremendous increase in safe and sound lending to traditionally underserved communities. It is one of the most important means by which to stimulate conventional lending institutions to compete against predatory lenders in lower-income and minority communities. But for CRA to succeed in this endeavor, it must be enforced rigorously.

The OTS should issue an advisory letter saying that predatory lending will not receive credit under CRA exams and will be penalized through lower CRA ratings and fair lending referrals to the Department of Justice.

Another important way the OTS has jurisdiction over the portion of the subprime market that is abusive and/or predatory is through its supervision of institutions which underwrite, purchase, and/or service mortgage-backed securities based on subprime loans by non-bank lenders. Clearly, the OTS can and should promulgate standards, as a matter of fair lending and CRA compliance, but also as a safety and soundness matter, for savings and loan holding company involvement with these subprime and predatory lenders. The case of savings and loan holding company Lehman Brothers, which, for instance, continued doing business with Delta Funding even after Delta was sued by the New York Attorney General and under scrutiny by HUD and other Federal agencies for discriminatory practices, highlights this pressing need.

As part of these standards, the OTS should promulgate rules governing purchases of subprime loans by OTS-regulated institutions. These rules should ensure that all subprime loan purchases meet sound underwriting and appraisal practices, and apply with all applicable federal fair lending and consumer protection laws. These rules should also be subject to a public comment period.

Finally, the OTS should enlist community and consumer organizations in a national campaign against predatory lending that has financial literacy training and education as its primary tenet.

Financial literacy is at the very core of healthy families and communities. A basic understanding of financial institutions and financial concepts is crucial to a person's ability to not only develop assets, but also steer clear of unscrupulous actors who seek to

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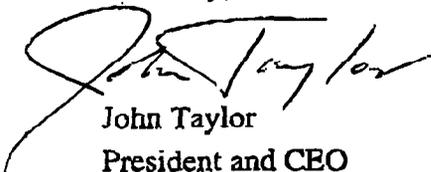
strip wealth away from vulnerable individuals and underserved communities. The OTS should work to provide funding to establish partnerships with nonprofit organizations engaged in community-based financial literacy efforts. These agencies should also undertake, in conjunction with community-based partners, a national advertising campaign aimed at educating consumers to "look before you leap," so to speak, when entering into loan agreements.

Conclusion

In urging caution on moving too fast on the regulatory front, one of Director Seidman's Colleagues, Federal Reserve Governor Edward Gramlich recently stated that while some subprime lenders may be predatory "elephants," most subprime lending contains terms and conditions that are "beneficial" to most "consumers."⁵ NCRC does not understand how exorbitant fees, stiff prepayment penalties, balloon payments, clauses that accelerate indebtedness, negative amortization that results in increased principle and interest, and other exploitative terms and conditions really benefit most consumers. These terms and conditions were not widespread in the early 1990's when the largest lending increases occurred to underserved populations.⁶ We believe that minority and lower-income populations do not require such terms and conditions in order to have access to credit.

NCRC appreciates the opportunity to comment and hopes its recommendations help inform the OTS's regulations to ensure that minority, low- and moderate-income, and elderly borrowers are fully protected from predatory lenders.

Sincerely,



John Taylor
President and CEO

⁵ See Remarks by Governor Edward M. Gramlich, at the Fair Housing Council of New York, Syracuse, New York, April 14, 2000.

⁶ See Litan, Robert et al. The Community Reinvestment Act After Financial Modernization: A Baseline Report. U.S. Department of the Treasury, April 2000.



List of OTS-Regulated Institutions Specializing in Subprime Lending

Bay Financial Savings Bank, FSB
Charter One Credit Corporation
Downey Savings and Loan Association
Home Loan & Investment Bank, FSB
Household Bank, FSB
NBC-FSB
Newsouth Financial Services, Inc.
North American Savings Bank, FSB
Oceanmark Bank, FSB
Ocwen Federal Bank, FSB
Superior Bank
Travelers Bank & Trust, FSB
Western Financial Bank
Life Bank