

BILLING CODE: 6720-01-P

**DEPARTMENT OF THE TREASURY**

**Office of Thrift Supervision**

**12 CFR Parts 560, 590 and 591**

**[No. 2002-17]**

**RIN 1550-AB51**

**Alternative Mortgage Transaction Parity Act; Preemption**

**AGENCY:** Office of Thrift Supervision, Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Alternative Mortgage Transaction Parity Act (Parity Act) authorizes state-chartered housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation. To rely on the Parity Act, certain state-chartered housing creditors must comply with regulations on alternative mortgage transactions issued by the Office of Thrift Supervision (OTS). In today's rulemaking, OTS proposes to revise its rule identifying the OTS regulations that apply to creditors under the Parity Act. OTS would no longer identify its regulations on prepayment and late charges for state housing creditors.

OTS is also proposing to revise existing limitations on the amount of late charge that may be assessed on loans secured by first liens on residential

manufactured homes under part 590. Part 590 addresses the preemption of certain state usury laws for federally-related residential mortgage loans. In addition, OTS is proposing a minor technical change to the definition of reverse mortgage in part 591, which addresses the preemption of state due-on-sale laws.

**DATES:** Comments must be received on or before June 24, 2002.

**ADDRESSES:**

Mail: Send comments to Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: Docket No. 2002-17. Commenters should be aware that there have been some unpredictable and lengthy delays in postal deliveries to the Washington, D.C. area in recent weeks and may prefer to make their comments via facsimile, e-mail, or hand delivery.

Delivery: Hand deliver comments to the Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9:00 a.m. to 4:00 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Docket No. 2002-17.

Facsimiles: Send facsimile transmissions to FAX Number (202) 906-6518, Attention: Docket No. 2002-17.

E-Mail: Send e-mails to [regs.comments@ots.treas.gov](mailto:regs.comments@ots.treas.gov), Attention: Docket No. 2002-17, and include your name and telephone number.

Availability of comments: OTS will post comments and the related index on the OTS Internet Site at [www.ots.treas.gov](http://www.ots.treas.gov). In addition, you may inspect comments at the Public Reading Room, 1700 G Street NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to [public.info@ots.treas.gov](mailto:public.info@ots.treas.gov), or send a facsimile transmission to (202) 906-7755. (Please identify the materials you would like to inspect to assist us in serving you.) We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the business day after the date we receive a request.

**FOR FURTHER INFORMATION CONTACT:** Theresa Stark, Senior Project Manager, Compliance Policy, (202) 906-7054; Karen Osterloh, Assistant Chief Counsel, (202) 906-6639, Regulations and Legislation Division, Office of Thrift Supervision, 1700 G Street NW., Washington, DC 20552.

**SUPPLEMENTARY INFORMATION:**

**I. The Alternative Mortgage Transaction Parity Act Regulations**

**(§ 560.220)**

**A. Background**

Congress enacted the Parity Act<sup>1</sup> in 1982 to stimulate credit in an unusually high interest rate environment by encouraging variable rate mortgages and other creative financing. In hearings before the Senate in 1981, mortgage

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<sup>1</sup> 12 U.S.C. 3801 et seq.

bankers testified that statutes in 26 states barred state-chartered mortgage bankers and lending institutions from originating alternative mortgage loans, or imposed significantly higher restrictions on such loans than applied to federally chartered lenders operating under federal regulations. Congress wanted to make more housing credit available by giving those state-chartered housing creditors<sup>2</sup> parity with federally chartered institutions and eliminate the discriminatory impact of the state laws by authorizing those creditors to make, purchase, and enforce alternative mortgage loans.<sup>3</sup>

The Parity Act applies to loans with any “alternative” payment features that vary from conventional fixed-rate, fixed term mortgage loans, such as variable rates, balloon payments, or call features. It allows state licensed and regulated housing creditors to engage in “alternative mortgage transactions” notwithstanding “any State constitution, law, or regulation,” provided the transactions are in conformity with regulations that would apply to a comparable federally chartered housing creditor.<sup>4</sup>

To qualify as a state housing creditor and take advantage of preemption, the Parity Act specifically provides that the creditor must be “licensed under

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<sup>2</sup> A “housing creditor” is a depository institution, a lender approved by the Secretary of Housing and Urban Development for participation in certain mortgage insurance programs, “any person who regularly makes loans, credit sales or advances secured by interests in properties referred to in [the Parity Act]; or . . . any transferee of any of them.” 12 U.S.C. 3802(2).

<sup>3</sup> 12 U.S.C. 3801(b). *See also National Home Equity Mortgage Association v. Face*, 64 F. Supp. 2d 584, 587 (E.D. Va. 1999), *aff’d*, 239 F.3d 633 (4<sup>th</sup> Cir. 2001), and *cert denied* 70 U.S.L.W. 3234 (U.S. Oct. 1, 2000)(No. 00-1851).

<sup>4</sup> *Id.*; 12 U.S.C. 3803.

applicable State law and [remain or become] subject to the applicable regulatory requirements and enforcement mechanisms provided by State law.”<sup>5</sup> Housing creditors, other than state-chartered banks and state-chartered credit unions,<sup>6</sup> that wish to make an alternative mortgage transaction under the authority of the Parity Act, must abide by designated OTS regulations. Those regulations are enforced by each state housing creditor’s applicable state regulator.

The Parity Act directed the Federal Home Loan Bank Board (Bank Board), OTS’s predecessor agency, to identify, describe, and publish those portions of its regulations that were inappropriate for, and thus inapplicable to, non-federally chartered, non-bank, non-credit union housing creditors.<sup>7</sup> In 1982, the Bank Board published a “Notice to Housing Creditors” (1982 Notice).<sup>8</sup> The 1982 Notice provided that state housing creditors, other than commercial banks, credit unions or federal associations, may make alternative mortgage loans subject to the Bank Board’s requirements on adjustments to rate, payment, balance or term of maturity and disclosure.

In 1983, the Bank Board published a final rule codifying a revised Notice to Housing Creditors. The 1983 final rule identified three provisions that were an integral part of, and particular to, alternative mortgage transactions. These

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<sup>5</sup> 12 U.S.C. 3802(2).

<sup>6</sup> State-chartered commercial banks and state-chartered credit unions must comply respectively with regulations of the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration (NCUA).

<sup>7</sup> Section 807 of Pub. L. 97-320 (1982).

<sup>8</sup> 47 Fed. Reg. 51733 (November 17, 1982).

included provisions governing the authority to make partially amortized or non-amortized loans and to adjust the interest rate payment, balance or term of maturity; limitations on adjustments on loans secured by borrower-occupied property; and requirements for disclosures on loans secured by borrower-occupied property that are not fixed-rated and fully amortized.<sup>9</sup>

When the 1982 Notice was issued, federal savings associations had a limited ability to impose prepayment penalties on alternative mortgage transactions.<sup>10</sup> While the ability of federal thrifts to impose prepayment penalties was expanded in 1984,<sup>11</sup> restrictions were not removed completely until 1993. At that time OTS allowed prepayment penalties at any time and in any amount authorized by the loan contract for both adjustable rate and fixed-rate mortgages.<sup>12</sup>

In January 1996, OTS proposed to designate additional rules as applicable under the Parity Act. Specifically, OTS proposed to designate all of proposed part 560 (rules on the lending powers of federal savings associations and safety and soundness-based lending provisions applicable to all savings associations) and proposed § 563.99 (fixed and adjustable-rate mortgage loan disclosures,

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<sup>9</sup> 48 Fed. Reg. 23,032, 23053 (May 23, 1983). The notice was codified as an appendix to part 545. In 1989, it was moved 12 CFR 545.33. See 54 FR 49492 (November 30, 1989).

<sup>10</sup> See 12 CFR 545.8-5(b)(1983).

<sup>11</sup> See 12 CFR 545.34(c)(1984).

<sup>12</sup> 58 FR 4308 (Jan. 14, 1993). Of course, federal thrifts must disclose prepayment penalties and late charges under the Federal Reserve Board's Regulation Z, which implements the Truth in Lending Act (15 U.S.C. 1601 et seq.). See 12 CFR 226.18(k) and (l)

adjustment notices, and interest rate caps).<sup>13</sup> In the final rule, OTS deleted the general reference to part 560, and specifically identified applicable regulations, including new references to late charges and prepayment provisions.<sup>14</sup> The list of OTS regulations currently applicable to state housing creditors now includes the following sections:

- § 560.33. This reference permits state housing creditors to impose late charges for any delinquent periodic payment and sets out certain limitations on the assessment of such late charges.
- § 560.34. This reference permits state housing creditors to impose a prepayment penalty and indicates how prepayments must be applied.
- § 560.35. This section addresses adjustments to interest rate, adjustments to the payment and loan balance, and the use of indices.
- § 560.210. This reference requires state housing creditors to provide initial disclosures and adjustment notices for variable rate transactions.

Housing creditors must comply with these requirements to obtain the benefit of the Parity Act's preemption of state laws.

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<sup>13</sup> 61 FR 1162, at 1166, 1174, and 1181 (January 17, 1996).

<sup>14</sup> 61 FR 50951, at 50955, and 50969 (September 30, 1996).

On April 5, 2000, OTS published an advance notice of proposed rulemaking (ANPR) entitled “Responsible Alternative Mortgage Lending. 12 FR 17811. The ANPR sought public comment on various questions in connection with its review of mortgage lending regulations. OTS specifically sought comment about possible amendments to § 560.220. To the extent that commenters addressed these issues, they are discussed below.

## **B. Proposed § 560.220**

### **1. Comments on the ANPR**

Consumer groups and states generally urged OTS to limit the applicability of the Parity Act regulations to enable the states to better regulate non-depository state housing creditors. These commenters contended that state housing creditors are taking advantage of OTS regulations on prepayment penalties and late fees by structuring otherwise fixed-rate, fixed term loans with features to make them alternative mortgages and thus avoid state restrictions on these charges. These commenters specifically suggested removing prepayment penalties and late fees provisions from the list of regulations applicable to state housing creditors because those provisions apply to all mortgage loans (not just

alternative transactions), arguing that they allow non-depository institutions to piggy back on federal preemption and facilitate predatory practices.<sup>15</sup>

Financial institutions and their trade organizations generally supported the existing Parity Act rules as enhancing credit availability and enabling lenders to develop new mortgage options. They argued that if the scope of the Parity Act regulations were significantly narrowed, state financial institutions potentially could be required to comply with 51 sets of state requirements, and that this would increase lending costs to consumers. Some commenters argued the Parity Act does not limit the scope of regulations applicable to housing creditors to those provisions concerning only alternative mortgage transactions.

## **2. Proposed revisions to § 560.220.**

OTS has reviewed the designation of the regulations on prepayments and late charges in light of the comments on the ANPR and the purposes of the Parity Act, and is proposing to delete these rules from the list of provisions that apply to state housing creditors under the Parity Act.

The Parity Act directs the Bank Board (now OTS), OCC and NCUA to identify, describe, and publish those regulations that are “inappropriate for and inapplicable” to state housing creditors. The Parity Act, however, provides little guidance to the agencies in determining which regulations are appropriate. As a

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<sup>15</sup> OTS does not collect information on housing creditors that take advantage of the Parity Act. Accordingly, OTS sought data on the extent to which housing creditors taking advantage of the Parity Act are engaged in predatory practices and the effect that the Parity Act has the availability of credit. While commenters offered anecdotal information, OTS received no comprehensive data in response to the ANPR.

result, NCUA, OCC, OTS, and the Bank Board have taken substantially different approaches to the designation of rules.

NCUA, for example, has identified all of its lending regulations as applicable to alternative mortgage transactions by state-chartered credit unions.<sup>16</sup> These mortgage regulations address such matters as the term of the loan, requirements governing security instruments, notes, and liens, due-on-sale provisions, and assumptions and, as required under the Federal Credit Union Act, specifically prohibit prepayment penalties.

In contrast, OCC has designated as applicable to state-chartered commercial banks its rules that directly relate to adjustable rate mortgages.<sup>17</sup> OCC's designated regulations define ARM loans, authorize certain indexes and allow prepayment fees.

The Bank Board initially identified as appropriate and applicable those regulations that "describe and define" alternative mortgage transactions and not those regulations intended for the general supervision of federal associations. Because agency rules on prepayment penalties and late charges applied to loans generally (as distinguished from rules that bear directly on the unique features of alternative mortgage loans), the Bank Board's Parity Act regulation did not identify these provisions.

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<sup>16</sup> 12 CFR 701.21(a) states "[W]hile § 701.21 generally applies to Federal credit unions only, its provisions may be used by state-chartered credit unions with respect to alternative mortgage transactions in accordance with 12 U.S.C. 3801 *et seq.*"

<sup>17</sup> 12 CFR 34.24, which applies 12 CFR part 34, subpart B.

In 1996, OTS took a different tack and added provisions on prepayment and late charges to the list of designated regulations. The designation occurred as part of a larger regulatory project to update and reorganize all of its lending and investment regulations. The proposed and final rules did not explain the reason for OTS departure from its predecessor agency's standard.

The proposed rule merely stated in one sentence that OTS would identify as appropriate and applicable to alternative mortgage transactions all of part 560 and §563.99. The preamble to the final rule, again in one sentence, merely stated that the rule was being "revised to identify the appropriate sections with greater specificity," and the rule itself then designated four particular provisions.

Between publication of the proposed and final rules, OTS issued a legal opinion to address a particular state law on prepayment penalties.<sup>18</sup> The opinion concluded that the application of the Parity Act to a state prepayment provision fell into a gray area between laws clearly preempted by the Act (those barring variable rate loans) and those clearly not (those governing liens and foreclosures.) The opinion recognized that the OTS prepayment provisions applied to all real estate loans for federal thrifts not just alternative mortgage transactions, but then simply stated that state housing creditors would be "disadvantaged vis-à-vis federal thrifts" if they had to comply with the state law restricting prepayment penalties and so concluded that it was preempted.

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<sup>18</sup> OTS Op. Chief Counsel (April 30, 1996).

The purpose of the Parity Act was to enable all housing creditors to provide credit with alternative mortgage vehicles and to preempt state laws that would prevent that type of credit.<sup>19</sup> The designation of §560.35 and §560.210 is essential to enable state housing creditors to continue to provide alternative mortgages. Accordingly, to provide parity with federal thrifts, OTS's proposed rule continues to designate these two provisions.

On the other hand, the OTS prepayment and late fee provisions are not intrinsic to the ability to offer alternative mortgages. We note that credit unions are barred by statute from imposing prepayment penalties on any loan, while OCC has specifically designated a prepayment penalty provision as applying to alternative mortgages. As for late fees, NCUA has designated its late fee provision as applying, while OCC has not. As these various approaches illustrate, the agencies have exercised broad discretion in their designations of appropriate regulations under the Parity Act and have struck different balances depending upon their statutory and regulatory scheme.

Certainly there are advantages and disadvantages to each charter and licensing scheme for the various types of housing creditors. Federal thrifts operate under a uniform system of safety and soundness and compliance rules nationwide, with regular examinations and close supervision. State thrifts have a

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<sup>19</sup> It is of note that the Parity Act makes no reference to fees or penalties nor does it direct the federal regulators to consider their impact on alternative mortgages.

somewhat similar system governing operations within their own jurisdictions. Other types of housing creditors are not bound by these restrictions and have more latitude in their operations.

OTS is proposing to delete § 560.34 and § 560.33 from the list of regulations designated for alternative mortgages. These two regulations apply to real estate loans in general and are part of a broader regulatory scheme governing the lending operations for federal thrifts.

OTS recognizes that state housing creditors may view this proposal as having a discriminatory impact on their ability to offer alternative mortgages. States that restrict prepayment penalties and late fees generally apply those restrictions to all real estate loans, not just to alternative mortgage transactions. The states' laws in these areas are not directed at restricting alternative mortgage transactions but in regulating mortgage transactions in general.

One of the congressional findings underlying the Parity Act was that OTS and the other federal regulators had adopted regulations authorizing their federally chartered institutions to offer alternative mortgages, and that the purpose of the Act was to eliminate the discriminatory impact of those regulations.<sup>20</sup> OTS regulations on prepayment penalties and late fees, however, were not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts the flexibility to exercise their

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<sup>20</sup> 12 U.S.C. 3801(a)(3) and (b).

lending powers under a uniform federal scheme. See 12 C.F.R. 560.2(a).

Therefore, OTS does not believe that Congress intended that regulations such as these would offer a basis for claiming discriminatory treatment or were needed to provide parity with federally chartered institutions. Indeed, OTS broadly allows federal thrifts to impose loan-related fees (e.g., initial charges and servicing fees) on any loan including alternative mortgages, notwithstanding any state law to the contrary. OTS also allows federal thrifts to process and originate any loan including alternative mortgages, without regard to state law. There is no basis for distinguishing prepayment penalties and late fees from these other OTS rules that apply generally to loans.

Accordingly, OTS proposes to delete the prepayment and late charge regulations from the list of regulations that apply to state housing creditors under the Parity Act. Under the proposed rule, OTS would identify only § 560.35 (adjustments to home loans) and § 560.210 (disclosures for variable rate transactions) as appropriate and applicable for state housing creditors.

OTS solicits comments on all aspects of this proposal and specifically requests comments on the following questions:

1. Has OTS correctly identified the factors it must weigh in determining whether a specific rule should be designated as applicable for state housing creditors? If not, which factors should OTS consider?

2. Has OTS appropriately and fairly applied these factors? Should OTS add any other regulations to the proposed list of designated regulations? Should OTS delete any regulation from the proposed list?

3. The Parity Act requires OTS to designate regulations for state housing creditors that include both depository institutions (state-chartered savings associations) and non-depository institutions. By contrast, OCC and NCUA designations, like the underlying regulations themselves, apply only to depository institutions (i.e., state chartered commercial banks and credit unions). Because state-chartered savings associations are subject to a safety and soundness regulatory scheme that is similar to that of federal thrifts and substantially different from other types of state-housing creditors, should OTS treat state-chartered savings associations differently under the Parity Act? Should OTS, for example, designate §§ 563.33 and 563.34 for state housing creditors that are depository institutions, but not for other types of state housing creditors? Does the Parity Act authorize OTS to differentiate between state housing creditors on this basis?

4. Sections 560.33 and 560.34 can be viewed as helping to promote safe and sound operations. For example, § 560.34 permits federal thrifts to moderate prepayment risk through the assessment of prepayment penalties; § 560.33 allows federal thrifts to encourage the timely payment of loans and to recover costs associated with late payments. In light of this, is it appropriate to apply

these rules to state-chartered housing lenders that are depository institutions?

Similarly, based on these safety and soundness considerations, should OTS apply

these rules to all real estate loans made by state savings associations? What

studies or empirical data exist to support the need to apply these rules to state

savings associations?

### **C. Recommendations for Statutory Changes.**

The majority of consumer groups and some states commenting on the ANPR advocated that OTS recommend that Congress repeal the Parity Act.

These commenters asserted that the Parity Act is no longer needed to circumvent state restrictions on adjustable rate mortgages since nearly all states now allow such transactions. These commenters contended that state housing creditors are now using the Parity Act to defeat states' attempts to impose reasonable consumer protection laws. Financial institutions addressing this issue generally opposed repeal of the Parity Act, because the Act enables financial institutions to offer uniform loan products across state lines, thereby lowering credit costs and increasing credit availability. These commenters contended that other federal laws exist to address predatory lending and consumer issues.

Legislative actions affecting the Parity Act are, of course, beyond the scope of this rulemaking. OTS believes, however, that Congress should revisit the Parity Act, possibly in the context of broader mortgage reform legislation

involving the Real Estate Settlement Procedures Act (RESPA),<sup>21</sup> the Home Ownership and Equity Protection Act (HOEPA),<sup>22</sup> or predatory lending. In contrast to the situation in the late 1970s and early 1980s, state regulators tell us that all states but one currently allow alternative mortgage transactions. If Congress believes that alternative mortgage transactions merit special treatment, it may want to consider whether it should enact a statute that applies equally to all entities providing alternative mortgage transactions, along the model of Regulation Z.

OTS has two additional recommendations in the event of Congressional review of the Parity Act. First, if the Act remains in place, states should be permitted another opportunity to opt out of the preemption provided by the Parity Act.<sup>23</sup> Congress originally gave the states a choice to opt out of the preemption provision so that housing creditors in that state would be bound by the state's regulations with respect to alternative mortgage transactions. Initially, the states had three years from the effective date of the Parity Act, from 1982 to 1985, to opt out of the preemption provisions. At the time, only a handful of states decided to reject preemption. However, today, with credit more readily available, the acceptance of alternative mortgage transactions by the states, and

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<sup>21</sup> Pub. L. No. 93-533, §2, (1974), 88 Stat. 1724, 12 U.S.C. 2601 et seq.

<sup>22</sup> Pub. L. No. 103-325 (1994), 108 Stat. 2160, amending the Truth in Lending Act, 15 U.S.C. 1601 et seq.

<sup>23</sup> 12 U.S.C. 3804(a).

the rising incidence of potentially predatory lending practices, additional states might possibly elect to opt out of the Parity Act if given the opportunity.

Second, OTS recommends that state housing creditors lending under the authority of the Parity Act be required to identify themselves to the states.

Currently, although the Parity Act provides the states with a mechanism to remove its preemption benefits from certain housing creditors, it is difficult for the states to do so without a reliable means of knowing who is a Parity Act creditor. Housing creditors may enjoy preemption benefits on alternative mortgage transactions only if those transactions are in substantial compliance with applicable federal regulations and the creditor timely cures any error.

Loans made under the aegis of the Parity Act lose the benefit of preemption and therefore must comply with state law if the housing creditor fails to cure any error within sixty days of discovery. The recommended notification provision would permit the states to better monitor the housing creditors taking advantage of the Parity Act preemption benefits and those in particular that fail to timely cure any errors.

## **II. Preemption of State Usury Law (12 CFR Part 590) – Late Fees on Federally-Related Residential Manufactured Housing Loans**

Part 590 implements section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) (12 U.S.C.

§ 1735f-7a),<sup>24</sup> which provides for the permanent preemption of state laws expressly limiting the rate or amount of interest, discount points, finance charges, or other charges assessed in connection with certain “federally-related” residential loans.<sup>25</sup>

This preemption does not apply to loans secured by a first lien on a residential manufactured home unless the terms and conditions of the loan comply with consumer protections provisions specified in OTS regulations at 12 CFR 590.4. These regulations address such matters as balloon payments, prepayment penalties, late charges, deferral fees, notice before repossession or foreclosure, and the refund of prepaid interest. Section 590.4(f) specifically addresses late charges. Among other requirements, this paragraph states: “To the extent that applicable state law does not provide for a lower charge . . . a late charge on any installment . . . may not exceed the lesser of \$5.00 or five percent of the unpaid amount of the installment.”

Thus, unless the installment on a manufactured housing loan is less than \$100, OTS’s rule permits a maximum \$5.00 fee for late payments on such loans. Over the years, OTS has received requests from representatives of manufactured housing lenders seeking the revision of this provision. These lenders argue that the \$5 amount is too small to deter late payments. They assert that the absence

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<sup>24</sup> Pub. L. 96-221, 94 Stat. 161 (1980).

<sup>25</sup> Loans are “federally-related” if the originator meets certain lender criteria, or the loan is classified as a federal agency loan, a federal housing program loan, or a loan eligible for purchase by government sponsored enterprises. See 12 CFR 590.2(b).

of a tangible penalty has contributed to a run-up of delinquencies and repossessions, and to increases to their costs of funds. Accordingly, these lenders have sought the deletion of the \$5.00 limit.

In today's rule, OTS is proposing to eliminate the \$5.00 limit. Under the proposed rule, the late fee would be limited to five percent of the unpaid amount of the installment, unless applicable state law imposes a lesser charge. OTS specifically requests comment whether this five percent limitation should also be deleted from the final rule.

### **III. Preemption of State Due-on-Sale Laws (12 CFR Part 591) – Definition of Reverse Mortgage**

OTS regulations at 12 CFR 591 implement section 341 of the Garn St Germain Depository Institutions Act of 1982 (12 U.S.C.A. 1701j-3)<sup>26</sup> This part governs the permissibility of due-on-sale clauses in real estate loans and the preemption of state prohibitions on such clauses.

OTS is proposing a minor technical change to the definition of reverse mortgage at 12 CFR 591.2(n). The rule would clarify that a reverse mortgage is not limited to a loan that provides for periodic payments, but also includes a loan

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<sup>26</sup> Pub. L. 97-320, 96. Stat. 1469 (1982).

that provides for a lump sum payment. This change is consistent with OTS legal opinions.<sup>27</sup>

#### **IV. Solicitation of Comments Regarding the Use of Plain Language**

Section 722 of the Gramm-Leach Bliley Act<sup>28</sup> requires federal banking agencies to use “plain language” in all proposed and final rules published after January 1, 2000. OTS invites comments on how to make this proposed rule easier to understand. For example:

(1) Have we organized the material to suit your needs? If not, how could the material be better organized?

(2) Do we clearly state the requirements in the rule? If not, how could the rule be more clearly stated?

(3) Does the rule contain technical language or jargon that is not clear? If so, what language requires clarification?

(4) Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand? If so, what changes to the format would make the rule easier to understand?

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<sup>27</sup> OTS Op. Chief Counsel (June 2, 2000) (reverse mortgage loans include those providing for a lump sum payment).

<sup>28</sup> 12 U.S.C. 4809.

**V. Executive Order 12866**

The Director of OTS has determined that this proposed rule does not constitute a “significant regulatory action” for purposes of Executive Order 12866.

**VI. Unfunded Mandates Reform Act of 1995**

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in expenditure by state, local, and tribal governments, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, Section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. OTS has determined that the proposed rule will not result in expenditures by state, local, or tribal governments or by the private sector of \$100 million or more. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995.

**VII. Regulatory Flexibility Act**

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) requires the agency to “prepare and make available for public comment

an initial regulatory flexibility analysis” which will “describe the impact of the proposed rule on small entities.” 5 U.S.C. § 603(a). Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

Parts 590 and 591. OTS has not prepared an initial regulatory flexibility analysis (IRFA) for the proposed revisions to parts 590 and part 591. The proposed change to part 590 affects creditors making federally-related loans secured by first liens on residential manufactured housing. The proposed change would provide these creditors with greater flexibility in charging late fees, while retaining the benefits of preemption of state usury laws under section 501 of DIDMCA. The current rule permits a limited late fee of \$5, which has proven to be too small to deter late payments. The proposed change permitting the imposition of a more tangible penalty will benefit all creditors making such loans, including small businesses. Part 591 permits all lenders, whether federally- or state-chartered, to exercise due-on-sale clauses in real property loans without regard to state law. OTS proposes a clarifying change broadening the definition of reverse mortgage. Since this change codifies an existing OTS interpretation of the term which broadens the availability of preemption under part 591, any impact on lenders should be beneficial. Accordingly, OTS certifies to the Chief Counsel of Advocacy of the Small Business Administration

that the proposed changes to parts 590 and 591 will not have a significant economic impact on a substantial number of small entities.

Section 560.210. OTS has performed an IRFA for the proposed changes to § 560.210.<sup>29</sup> A description of the reasons why OTS is considering the proposed change and a statement of the objectives of, and legal basis for, this aspect of the proposed rule are included in the supplementary material above. In addition, OTS has addressed the following topics.

**A. Small entities to which the proposed rule would apply**

The proposed change to § 560.220 would apply to state housing creditors other than credit unions or commercial banks. OTS does not compile data on the total number of state housing creditors that may utilize § 560.220. Moreover, except for state-chartered savings associations, OTS does not have any authority to require state housing creditors to identify themselves or submit other data to OTS. Similarly, the Parity Act does not require state housing creditors to notify the states that they are taking advantage of the Act. As a result, OTS has little

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<sup>29</sup> OTS questions whether an IRFA is required. The RFA does not require an agency to analyze the effects of a rule on entities that it does not regulate. See American Trucking Association, Inc. v. EPA, 175 F.3d 1027 (D.C. Cir. 1999)(The D.C. circuit held that EPA was not required to perform a RFA for its national ambient air quality standards (NAAQS). The NAAQS themselves imposed no regulations on small entities. Instead, the several states regulated small entities through the state implementation plans that they were required to develop under the Clean Air Act. Because the NAASQ regulated small entities only indirectly -- that is, insofar as they affected the planning decisions of the states -- the EPA concluded, and the D.C. circuit agreed, that small entities were not subject to the rule.)

As revised, § 560.210 imposes no restrictions or limitations on any small entity's ability to impose prepayment penalties or late charges. Rather, the proposed OTS rule would leave the regulation of these matters entirely to the discretion of the individual states. As a result, OTS believes that it may certify that the rule will not have a significant impact on a substantial number of small entities.

information regarding how many state housing creditors may use § 560.220 or how many of these creditors are small businesses.

Nonetheless, OTS estimates that 6,386 small state housing creditors may be affected by this regulation. United States Census data indicates that 7,257 firms (excluding depository institutions) engage in real estate credit. OTS estimates approximately 6,300 of these firms are small businesses.<sup>30</sup> Based on the most recent TFR data for thrifts, OTS estimates that an additional 86 state-chartered savings associations are small businesses.<sup>31</sup> For the purposes of this analysis, we have assumed that all 6,386 of these small businesses engage in alternative mortgage transactions.

OTS believes that this number may overstate the number of small businesses that may be affected by the changes to the proposed rule for several reasons. First, the use of the Parity Act is solely at the election of the state housing creditors. State housing creditors may, for whatever reason, decline to use the Parity Act for their alternative mortgage transactions. Moreover, many small state housing creditors will conduct alternative mortgage transactions that are governed by laws in states that either:

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<sup>30</sup> OTS based this figure on firms engaged in real estate credit and reported under NAICS 522292. A firm engaged in real estate credit is considered to be small if it has total receipts of \$5 million or less per year. 13 CFR 121.201. OTS has used the special tabulation of the 1997 economic census from the United States Bureau of the Census to determine the number of these firms and their annual receipts.

<sup>31</sup> Based on December 2001 TFR data, OTS regulates 138 state savings associations. Of these savings associations, 86 have assets of \$100 million or less. Small depository institutions are generally defined, for RFA purposes, as those with assets under \$100 million. See 13 CFR 121.201.

- Opted out of the Parity Act. State housing creditors conducting alternative mortgage transactions governed by these laws currently cannot use § 560.220 to preempt state law; or
- Enacted statutes that do not impose any substantive prohibitions and restriction on prepayment penalties or late charges for the loans. State housing creditors may continue to charge penalties and fees on alternative mortgage transactions in these states, notwithstanding the proposed changes to § 560.220.

OTS's estimate of 6,386 small businesses is based on the best information available to it. However, OTS encourages any commenter with access to more complete and more accurate data to submit information regarding the number of state housing creditors (other than credit unions or commercial banks) that may be affected by this rule. OTS also requests information regarding how many of these creditors that may be small businesses.

#### **B. Requirements of the proposed rule**

The Parity Act permits certain state housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law or regulation, provided that they comply with regulations designated by OTS. As described more fully in the supplementary information section, the proposed rule would revise OTS's designation of applicable

regulations so that it would no longer designate rules on prepayment and late charges. As a result, these state housing creditors would be subject to state laws limiting prepayment penalties and restricting late charges.

OTS is unable to quantify the impact of the proposed revision on small state housing creditors for several reasons. Based on available data, it is difficult to determine how many alternative mortgage transactions were made under the OTS Parity Act regulations. Industry-wide data is available only for one type of alternative mortgage transaction – adjustable rate mortgages (ARMs). Other types of mortgages with alternative features are generally reported as fixed rate mortgages. The available data, however, indicates that all housing lenders originated \$243.6 billion and \$256 billion in ARMs in 2001 and 2000 respectively.<sup>32</sup> The most recent data available indicated that state housing creditors (excluding commercial banks and thrifts) account for approximately 56.3 percent of all lending or \$137.1 billion and \$144.1 billion of ARMs in 2001 and 2000.<sup>33</sup> OTS estimates that \$14.7 billion and \$15.4 billion of these ARM loans were originated by small state housing creditors in 2001 and 2000.<sup>34</sup> This available data, however, does not distinguish between transactions that are made

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<sup>32</sup> Mortgage Bankers Association website at [www.mbaa.org](http://www.mbaa.org) indicates that the industry originated \$2,030 billion in 1-to 4- family mortgages in 2001, and \$1,024 billion of these loans in 2000, and that 12% and 25% of these loans were ARMs in 2001 and 2000.

<sup>33</sup> This information was also obtained on the Mortgage Bankers' Association's website, which indicates that its source was a HUD Survey of Mortgage Lending Activity discontinued in 1998. This data applies to all lending and is based on 1997.

<sup>34</sup> OTS computed this figure using receipts by real estate creditors as proxy for originations. Based on these figures, OTS estimates that small creditors accounted for 10.7% of all ARM originations by real estate creditors.

under the Parity Act, and those that are not. As noted above, OTS has no authority to require state housing creditors that use § 560.220 to provide this information.<sup>35</sup>

In the ANPR, OTS attempted to obtain additional information on the extent to which state housing creditors engage in alternative mortgage transactions under the Parity Act. Commenters, however, provided no reliable information on this subject.<sup>36</sup> Nonetheless, OTS encourages any commenter with access to more complete and more accurate data to submit information regarding the extent to which small state housing creditors engage in alternative mortgage lending under § 560.220.

OTS further requests information concerning the amount of late fees and prepayment penalties generated by these alternative mortgage transactions. OTS notes, however, that reliable estimates of the amount of late fees and prepayment penalties would not accurately reflect the impact of the deletion of the preemption of prepayment charge provisions and late charge provisions. The 6,386 small state creditors that may be affected by the proposed rule would

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<sup>35</sup> OTS does not currently collect data on the ARM originations by the 86 small state savings associations. However, 2000 CMR data indicates that these 86 thrifts hold approximately \$815 million of ARMs in their portfolios. Again, this data does not distinguish transactions subject to the Parity Act regulations.

<sup>36</sup> Specifically, OTS asked for information regarding predatory or abusive lending practices that would be contrary to State law but for the Parity Act. One of the commenters, a trade association representing a substantial segment of the real estate financing community, including national and regional lenders, mortgage brokers, mortgage conduits, and service providers stated that it “does not have specific numbers regarding the extent to which lenders are using the Parity Act to craft alternative mortgage products that would otherwise be affected by state law. Furthermore [it] knows of no reliable and comprehensive industry data from any source.”

become subject to a broad range of state laws. For example, some of these laws would continue to permit the imposition of prepayment penalties. Others may prohibit or restrict prepayment charges. Still other laws would subject prepayment penalties to a range of restrictions, such as prohibiting penalties for a set period after execution of the note or mortgage or limiting the amount of the prepayment penalty. Based on this wide variety of restrictions and the fact that current state laws will change over time, it is difficult to estimate how much of the income would be lost by small state housing creditors under the proposed rule.<sup>37</sup>

Moreover, the impact of the loss of prepayment penalties may be ameliorated somewhat through other techniques. For example, lenders often impose a higher overall interest rate where prepayment penalties are excluded from the loan agreement.<sup>38</sup> In addition, some commentators assert that the payment of points upon origination and the imposition of a prepayment penalty are economically equivalent transactions. Since a mortgage with points includes an implicit and easily calculable prepayment penalty, state housing creditors may substitute points where prepayment penalties are prohibited.<sup>39</sup>

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<sup>37</sup> See “The Handbook of Mortgage-Backed Securities,” 88-101 (Frank J. Fabozzi, ed. (5<sup>th</sup> ed. 2001)), which contains a compilation of current state laws on prepayment penalties.

<sup>38</sup> In April 2000, one large subprime lender indicated that it lowered the interest rate on a loan by 75 basis points for those borrowers who accepted a prepayment penalty. See Joint HUD/Treasury Report on Recommendations to Curb Predatory Home Mortgage Lending (April 20, 2000), citing information from the New Century Mortgage Corporation website, [www.newcentury.com](http://www.newcentury.com).

<sup>39</sup> Alan L. Feld & Stephan G. Marks, Legal Differences Without Economic Distinctions: Points, Penalties, and the Market for Mortgages, 77 B.U.L. Rev 405 (1997).

OTS requests information quantifying the impact that the proposed revision will have on small state housing creditors.

### **C. Significant alternatives**

Section 603(c) of the RFA requires OTS to describe any significant alternatives to the proposed rule that accomplish the stated objectives of the rule while minimizing any significant economic impact of the rule on small entities. Section 603(c) lists several examples of significant alternatives, including: (1) establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) clarifying, consolidating, or simplifying compliance and reporting requirements for small entities; (3) using performance standards rather than design standards; and (4) excepting small entities from coverage of the rule or a part of the rule.

OTS considered retaining its current designation of regulations for all state housing creditors. For the reasons noted in the preamble above, OTS believes that this course is inappropriate. OTS also considered whether it should continue to designate the existing regulations for small state housing creditors, but not for other state housing creditors. However, given its analysis of the purposes and goals of the Parity Act, OTS has concluded that it is inappropriate to distinguish between small and large state housing creditors. OTS solicits

comment any other alternatives that would minimize the burdens on small state housing creditors.

#### **D. Other Matters**

Various federal rules or statutes duplicate or overlap with the proposed rule. NCUA has identified all of its lending regulations as applicable to alternative mortgage transactions by state-chartered credit unions. 12 CFR 701.21(a). These regulations address such matters as the term of the loan, requirements governing security instruments, notes, liens, due-on-sale provisions, and assumptions and, as required under the Federal Credit Union Act, specifically prohibit prepayment penalties. OCC, on the other hand, had designated as applicable to state-chartered commercial banks, its rules that directly relate to adjustable rate mortgages. OCC's designated regulations define ARM loans, authorize certain indexes, and allow prepayment fees. 12 CFR 34.24. In addition, other federal statutes and rules may preempt the application of state laws on prepayment penalties and late fees for alternative mortgage transactions by state housing creditors. See e.g., 12 CFR part 590 (preemption of state usury laws under section 501 of DIDMCA ) and 12 CFR part 591 (preemption of state due on sale clauses under section 341 of Garn St Germain Depository Institutions Act of 1982).

OTS is aware of no federal rules or statutes that conflict with the proposed rule.

### **VIII. Federalism**

Executive Order 13132 imposes certain requirements on an agency when formulating and implementing policies that have federalism implications or taking actions that preempt state law. In accordance with those requirements, OTS has consulted with the Conference of State Bank Supervisors and the National Association of Attorneys General concerning this proposed change.

#### **List of Subjects**

##### 12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities.

##### 12 CFR Part 590

Banks, Banking, Loan programs - housing and community development, Manufactured homes, Mortgages, Savings associations.

##### 12 CFR Part 591

Banks, Banking, Loan programs - housing and community development, Mortgages, Savings associations.

Accordingly, the Office of Thrift Supervision proposes to amend 12 CFR parts 560, 590, and 591 as set forth below:

## **PART 560 – LENDING AND INVESTMENTS**

1. The authority citation for part 560 continues to read as follows:

**Authority:** 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1701j-3, 1828, 3801, 3802, 3803, 3806; 42 U.S.C. 4106.

2. Revise § 560.220 to read as follows:

### **§ 560.220 Alternative Mortgage Transactions Parity Act.**

(a) Applicable housing creditors. A housing creditor that is not a commercial bank, a credit union, or a Federal savings association may make alternative mortgage transactions by following the regulations identified in paragraph (b) of this section, notwithstanding any state constitution, law, or regulation. See 12 U.S.C. 3803.

(b) Applicable regulations. OTS designates §§ 560.35 and 560.210 as appropriate and applicable for state housing creditors. All other OTS regulations are not identified, and are inappropriate and inapplicable to state housing creditors. State housing creditors engaged in credit sales should read the term “loan” as “credit sale” wherever applicable in applying these regulations.

**PART 590 – PREEMPTION OF STATE USURY LAWS**

3. The authority citation for part 590 continues to read as follows:

**Authority:** 12 U.S.C. 1735f-7a.

4. Revise the section heading and paragraph (f)(4) in § 590.4 to read as follows:

**§ 590.4 Federally-related residential manufactured housing loans -  
consumer protection provisions.**

\* \* \* \* \*

(f) \* \* \*

(4) To the extent that applicable state law does not provide for a lower charge or a longer grace period, a late charge on any installment not paid in full on or before the 15th day after its scheduled or deferred due date may not exceed five percent of the unpaid amount of the installment.

\* \* \* \* \*

**PART 591 – PREEMPTION OF STATE DUE-ON-SALE LAWS**

5. The authority citation for part 591 continues to read as follows:

**Authority:** 12 U.S.C. 1464 and 1701j-3.

6. Revise § 591.2(n) to read as follows:

**§ 591.2 Definitions.**

\* \* \* \* \*

(n) Reverse mortgage means an instrument that provides for one or more payments to a homeowner based on accumulated equity. The lender may make payment directly, through the purchase of annuity through an insurance company, or in any other manner. The loan may be due either on a specific date or when a specified event occurs, such as the sale of the property or the death of the borrower.

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DATED: April 19, 2002

By the Office of Thrift Supervision.

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James E. Gilleran  
Director