

02-029

CHAPTER 142

Regulation #42

CHARGES PERMITTED FOR PREPAYMENT OF CERTAIN CONSUMER LOANS

SUMMARY

Public Law 2003, Chapter 263, § 1, effective September 13, 2003, amended Title 9-A MRSA § 2-509. The amendment authorizes supervised financial organizations to assess a consumer a reasonable charge related to the prepayment of a consumer loan secured by an interest in land. That charge must be reasonably calculated to offset only the cost of origination of the loan. Title 9-A M.R.S.A. § 2-509 as amended requires the Superintendent to adopt rules to implement its provisions. Rules adopted pursuant to § 2-509 are routine technical rules as defined in Title 5, chapter 375, sub-chapter 2-A.

I. AUTHORITY

Title 9-A MRSA §2-509 authorizes the Superintendent to adopt rules to implement the changes in statute which permit a supervised financial organization to assess a consumer a reasonable charge related to the prepayment of a consumer loan secured by an interest in land.

- Title 9-B MRSA §111 declares that it is the policy of the state to supervise financial institutions in a manner to assure their strength, stability, and efficiency and to encourage development and expansion of financial services advantageous to the public welfare.
- Title 9-B MRSA §215 authorizes the Superintendent to implement by rule any provision of law relating to the supervision of financial institutions.
- Title 9-B MRSA §241 and 242 address anticompetitive or deceptive practices.
- Title 9-B MRSA §251 states that rules promulgated by the Bureau must conform to the requirements of the Maine Administrative Procedures Act.

II. PURPOSE

This rule establishes guidelines to be followed by a supervised financial organization that assesses a charge intended to recover reasonable loan origination costs upon full repayment, through refinancing or otherwise, of a consumer loan secured by an interest in land, when repayment occurs prior to the end of the loan's contractual term, or in the case of open-end credit secured by land, when the balance is reduced to zero and the open-end credit plan is terminated by the consumer prior to the contractual termination date of the

open-end credit plan. This rule does not permit a supervised financial organization to assess a prepayment charge or prepayment penalty designed to recover anticipated revenue.

III. DEFINITIONS

For purposes of this rule, the following terms have the following meanings:

- "Reasonable cost of originating the loan" means the identified direct and indirect costs of originating the loan.
- "Consumer" has the same meaning as in 9-A MRSA § 1-301(10).
- "Consumer loan" has the same meaning as in 9-A MRSA § 1-301(14), excluding a high-rate, high-fee mortgage as defined in 9-A MRSA § 8-103(1)(F-1).
- "Prepayment charge" means a fee that is assessed to a consumer if the consumer repays a consumer loan in full, through refinancing or otherwise, prior to the end of the contractual term of the loan, and in the case of open-end credit plans, the consumer repays the balance to zero and terminates the open-end credit plan prior to the contractual termination date of the open-end credit plan.
- "Supervised financial organization" has the same meaning as in 9-A MRSA § 1-301(38-A).

IV. GENERAL PROVISIONS

Except as provided in Section V, a supervised financial organization may assess a prepayment charge to recover the reasonable cost of originating the loan, when a consumer repays a consumer loan, secured by an interest in land, in full prior to the maturity date of the loan, or in the case of open-end credit, when a consumer repays the line to zero and terminates the open-end credit plan prior to the contractual termination date of the open-end credit plan. Prepayment charges that do not exceed "closing costs" as defined in Title 9-A Section 1-301(8), excluding prepaid interest, that are actually incurred by the supervised financial organization, but are not charged to the consumer, meet the definition of "reasonable cost of originating the loan" as defined in Subsection A of Section III of this rule. Any prepayment charge assessed in accordance with the foregoing must meet the following two requirements.

- The dollar amount of the prepayment charge must be disclosed in the note or other document establishing the loan or credit plan. The prepayment charge may not exceed what was disclosed nor may the prepayment charge exceed the total of the reasonable direct and indirect costs of originating the loan that were actually incurred by the supervised financial organization, but were not charged to the consumer.

- The prepayment charge may only be assessed if the loan is repaid in full within 36 months of the origination date of the loan or the open-end credit plan is repaid to zero and terminated within 36 months of the origination date of the open-end credit plan.

V. EXCEPTIONS

- No prepayment charge may be assessed for (1) consumer loans with an original maturity date of 36 months or less or (2) open-end credit plans with an original termination date of 36 months or less.
- No prepayment charge may be assessed, if the consumer prepays the consumer loan or open-end credit plan in response to a change in terms notification issued pursuant to Title 9-A § 8-103(1)(F-1) on November 8, 2018. No prepayment charge may be assessed if the consumer prepays the consumer loan or open-end credit plan when the supervised financial organization exercises its right to accelerate the loan in the event of default.
- No prepayment charge may be assessed if a consumer rescinds the transaction pursuant to 12 CFR §226.15 or 226.23.
- No prepayment charge may be assessed for early repayment of a high-rate, high-fee mortgage as defined in Title 9-A § 8-103(1)(F-1).

VI. FEDERAL RULES AND REGULATIONS.

The Federal Deposit Insurance Corporation, the Federal Reserve System, the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration have promulgated or may, in the future, promulgate regulations or guidelines governing the manner in which a supervised financial organization can assess charges for early repayment of a consumer loan. There may exist some difference between this rule and a regulation promulgated by a federal regulatory agency. It is not the intent of this rule to permit any practice that is not permitted by a federal regulatory agency.

BASIS STATEMENT:

9-A M.R.S.A. §2-509 authorizes a supervised financial organization to assess a charge intended to recover reasonable loan origination costs upon full repayment, through refinancing or otherwise, of a consumer loan secured by an interest in land. This rule defines reasonable loan origination costs and sets forth the guidelines by which they may be assessed. This rule does not permit a supervised financial organization to assess a prepayment charge or prepayment penalty designed to recover anticipated revenue.

RESPONSES TO COMMENTS

In response to the proposed rule, the Bureau received comments submitted by six interested parties: John Opperman on behalf of Banknorth, N.A.; Christopher Pinkham on behalf of the Maine Association of Community Banks and their 17 state-chartered members; Mark Walker representing the members of the Maine Bankers Association; Jill Knight for Maine Bank & Trust Company; Ryan Stinneford from the law firm of Pierce, Atwood, and Gretchen Jones from the law firm of Skelton, Taintor & Abbott on behalf of the Maine Credit Union League. Although the comments are categorized by the manner in which they were received, they are identified as follows by topic and numbered sequentially for ease of reference.

General Provisions: The following comments were received with respect to Section III of the proposed rule. The Bureau's response follows and those changes have been incorporated into the final rule under renumbered Section IV.

- Several comments suggested that the rule improperly limits the reasonable cost of origination of the loan. Those comments said that by adopting the definition of "closing cost" in 9-A M.R.S.A. §1-301(8) less prepaid interest, the rule unnecessarily restricts those recoverable costs to a statutory list which does not recognize other costs that may vary among lenders and may include: administrative or personnel, vendor costs, and operational costs. It was suggested that the statute clearly permits reasonable recovery of those costs and the proposed rule ignores that intent in adopting the more restrictive "closing cost" definition. One commenter suggested that the competitive market will ensure that "prepayment fees" stay at levels acceptable by consumers. Finally, reference was made to recent issuances by the Office of the Comptroller of the Currency, which provide guidance to national banks with respect to the setting of non-interest charges and fees. That regulatory agency recognized that the cost incurred by the bank in providing the services should be considered when setting a fee.

The Bureau has considered the additional information provided by the commenters regarding the variety of indirect costs that can be incurred by a financial institution in the origination of a consumer loan or line of credit secured by real estate. The Bureau understands the potential disadvantages regarding parity that arise when Maine chartered financial institutions are placed under more restrictive guidelines than federally chartered institutions. The draft rule takes a restrictive approach to the definition of "reasonable costs of originating a loan" coupled with extensive disclosure requirements. Certainly, market forces could provide a mechanism that will keep such fees under control. The Bureau has adopted the provision that the prepayment charge may not exceed the total of the reasonable direct and indirect costs that are actually incurred by the supervised financial organization, but not charged to the

consumer. Finally, this rule does not abridge the Bureau's authority under Title 9-B Chapter 24 to institute procedures to determine if the manner and method of actual pricing of any product or service is anticompetitive, unfair, deceptive, or otherwise injurious to the public interest. Given the foregoing, the Bureau has adopted a definition of "reasonable cost of originating the loan" that permits both direct and indirect costs of originating a loan to be considered in the establishment of a prepayment charge, and adopted disclosure requirements that will ensure proper disclosure of those costs occurs.

- Several comments raised concerns that the proposed rule would impose new disclosure requirements for state-chartered financial institutions. The proposed rule would require disclosure of an itemized list of all "closing costs", including waived closing costs, at the time of the loan origination. Concern was raised that those provisions of the proposed rule had the effect of imposing a new disclosure scheme on home equity line of credit lenders and that federal disclosure requirements for those products do not require that extensive and detailed a disclosure statement. Under current law, home equity line of credit lenders are required to disclose, at the time of application: 1) an itemized list of fees imposed on the borrower by the lender to open, use and maintain the home equity line 2) an aggregate single dollar amount or range (not an itemized list) of fees imposed by third parties to open the plan, and 3) a statement that the applicant can obtain an itemized list upon request. It was suggested that an additional disclosure as required under Section III of this rule would require a significant investment of resources of both time and money by lenders and, in effect, frustrate the intent of the Maine Legislature by enactment of the amendments to Title 9-A §2-509.

Consumers must receive sufficient information with respect to loans or credit plans with which to make informed decisions. Since state and federal rules currently require disclosure of fees associated with the origination of consumer loans or lines of credit, the Bureau recognizes that borrowers already receive considerable information regarding the cost of credit. The additional disclosures required under proposed Section III, in many respects, are duplicative of existing requirements and may tend to confuse, rather than educate, consumers. Therefore, the rule has been amended to require that only the dollar amount of the prepayment charge be disclosed in the note or other document which establishes the loan or credit plan. The prepayment charge may not exceed that amount which is disclosed. In addition, the prepayment charge may not exceed the total of the direct and indirect costs of originating the loan that are actually incurred by the supervised financial organization, but not charged to the consumer.

- Several concerns were raised regarding the pro rata calculation of the prepayment charge. Some said that the proposed tiered scheme was both

confusing and unnecessarily restrictive for supervised financial organizations that incur, but waive, significant costs of making those loans. Others identified significant operational burden to properly administer such a program. Some complained that the two year limitation for recovery of the reasonable cost of originating a loan is too short a period of time when you consider that supervised financial organizations may be amortizing those costs over a much longer period of time, e.g., closed end loans generally have terms of up to 30 years and home equity lines sometimes have terms of 40 years. One party suggested a 48 month term to recover costs with a two-year incremental approach. Others suggested a 36 month outside limit with no tiering of fees. Finally, some responders raised concerns that this more limited recovery of origination costs placed state-chartered supervised financial organizations at a competitive disadvantage because out-of-state organizations, specifically federally chartered financial institutions, can (and do) charge flat prepayment fees on loans to Maine consumers under guidelines issued by federal regulators.

In response to comments, the Bureau has eliminated the tiered approach to the assessment of prepayment charges. In its place, the rule permits a prepayment charge that may be assessed for early repayment at any time during the first 36 months of the life of the loan or credit line. That charge may take the form of a flat fee as long as the amount of the charge does not exceed the reasonable cost of originating the loan as defined in the rule. Mandatory disclosure requirements have been retained.

Exceptions: The following comments were received with respect to Section IV of the proposed rule. The Bureau's response follows and those changes have been incorporated into the final rule under renumbered Section V.

- No prepayment charge may be assessed if the loan is refinanced with the original lender. One responder was concerned that, depending upon the complexity of the transaction, there can be substantial cost to refinance a loan. The longer that a loan or credit line is in existence prior to refinancing may require the supervised financial organization to request a credit report, require a new appraisal, review title work, or conduct other activities essential to prudent underwriting procedures, and there is a cost associated with each of these activities. The proposal to prohibit a prepayment charge if the loan is refinanced with the original lender would inhibit lender's ability to meet the refinancing needs of its customers as well as place it at a disadvantage with other federally chartered financial institutions that are not so restricted.

In response to comments, the final rule has been revised to eliminate the prohibition against assessing a prepayment charge if the loan is refinanced with the original lender.

- No prepayment charge may be assessed, if the consumer makes payments on the loan in amount(s) larger than required by the terms of the note and the lender accepts such payments. Two responders requested that this exception be deleted. One suggested that this exception seemed so broad as to swallow the rule as, in most instances, the prepayment will consist of accepting a "larger than required" payment. Another said that, read literally, the provision would prohibit a lender from recovering any charges if the early repayment is made in connection with one or more regularly scheduled payments. That same person opined that an open end line of credit agreement may not include a conventional "note", which would make this exception more confusing.

The general provisions of the rule (Section III) have been modified to make it clear that the prepayment charge may be assessed only when a loan is paid in full prior to the maturity date of the loan or when the open-end credit line has been reduced to zero and the open-end credit plan is terminated prior to the contractual termination date of the plan. That more specific regulatory guidance obviates the need for the foregoing exception, which is being deleted from the final rule.

- No prepayment charge may be assessed, if the consumer prepays the loan when the supervised financial organization exercises its right to accelerate the loan in the event of default. One person suggested that this exclusion could be taken advantage of by some unscrupulous consumers who may intentionally default in order to provoke acceleration and avoid payment of early repayment charges. Under the draft rule, no charges could be recovered if the acceleration took place more than twenty-four (24) months after the transaction. Given the foregoing, the responder requested that the exception for prepayment in the event of default be eliminated from the rule.

This provision was patterned after federal rules and secondary market guidelines on predatory lending practices. The right to accelerate the repayment of a loan in the event of default resides exclusively with the supervised financial organization and generally that event occurs when the consumer has not made several payments on the obligation. While it is possible that a person could take advantage of this exclusion in order to avoid paying a prepayment charge, it seems unlikely that an individual would risk losing his or her home by defaulting on a loan just to save that cost. The Bureau believes that the protective nature of this provision outweighs the potential for abuse. Therefore, this exception is being retained in the final rule.

Miscellaneous: The following general comments were received with respect to the proposed rule. The Bureau's response follows and those changes have been incorporated into the final rule.

- Clarify that the rule applies to home equity lines of credit - One comment suggested that it is not completely clear that the rule applies to open-end home equity lines of credit requested and that the rule be clarified accordingly.

Modifications have been made to the rule to clarify that the rule and permissible prepayment charges may be applied to all consumer loans or lines of credit secured by land, except high-rate, high-fee loans.

- Disclosures, advertising – Several responders raised concerns with Section V of the proposed rule. Some said that the requirement that advertisements must contain a detailed explanation of how the prepayment charge would be calculated is unnecessarily burdensome. Others suggested that would cause creditors to include lengthy legal disclosures which would be particularly problematic for broadcast media advertisements (i.e. radio and televisions ads). Another opined that Title 9-A Section 2-509 does not contemplate advertising requirements in connection with prepayment charges, and suggested that any attempt to impose such requirements could result in a challenge to the rule.

Existing state laws and rules authorize the Superintendent to issue orders or make determinations with respect to advertising that may be considered false, misleading, or otherwise deceptive. Those provisions provide the Superintendent with the tools to take such affirmative correction action as he deems necessary and appropriate for the purpose of protecting the public. Regulation #42 is being issued under statutory authority found both in Title 9-A and Title 9-B, which provides broad based rule-making foundation. Therefore, while Title 9-A Section 2-509, on its face, does not address advertising, the Bureau believes that it has sufficient statutory foundation to include an advertising requirement.

However, the draft rule has undergone other changes with respect to disclosure and limitations imposed on prepayment charges and, as a result, those protective measures generally address the notification issues embodied in proposed Section V. Based on the foregoing, the Bureau no longer believes that explicit advertising rules are necessary. Therefore, Section V., "Disclosures, advertising", and the definition of "advertising" in Section II, have been removed from the final regulation.

- One responder observed that the proposed rule used the term "financial institution" interchangeably with the term "supervised financial organization" and that person suggested that the term "supervised financial organization" should be used throughout the rule.

The Bureau has accepted this suggestion and made the necessary modifications.

- Finally, it was suggested that the term "prepayment charge" may connote that the consumer is somehow being penalized. Because some institutions may only recover the actual costs of early termination, it was suggested that the word "prepayment" be deleted.

Neither the proposed nor the final rule requires that a specific term be utilized in the descriptive disclosure of the prepayment charge. Lenders are currently utilizing terms such as "early termination fee" or "early cancellation fee" to describe such charges. Those terms, or derivations thereof, would be equally acceptable to the extent that they accurately reflect the nature of the charge that may be assessed to a consumer.

EFFECTIVE DATE: March 24, 2004