State of Michigan
John Engler, Governor

Department of Consumer & Industry Services
Kathleen M. Wilbur, Director

Financial Institutions Bureau
Gary K. Mielock, Acting Commissioner

P.O. Box 30224
Lansing, MI 48909

333 S. Capitol, Suite A
Lansing, MI 48933

Tel. (517) 373-7279
Fax (517) 335-1109

November 29, 1999

YYY
XXXX
XXXXXXX
XXXXXXX

Dear YYY:

This letter is in response to your letter dated August 16, 1999, regarding the mortgage loan between XXX and ZZZ. Please be advised that I have discussed this matter with my staff and, based on the following, find your broad statement that if a consumer chooses "to sell their property prior to the expiration of the pre-payment period, then notwithstanding XXXX's ability to call a default for a transfer without our consent, XXXX is still entitled to collect our pre-payment penalty" to be unsupportable.

Your letters to the Bureau and the ZZZs argue that the prepayment penalty XXXX is attempting to extract is not only permissible under law, but is required because the prepayment penalty enabled XXXX to grant the "loan at the rate and on the terms" received. In short, XXXX argues that because the ZZZ's are voluntarily selling their home, they "should not be allowed to avoid their known, freely entered, contractual obligations."

To explain our disagreement with XXXX in this regard, it is important to review the applicable statutes and regulations. The main federal statute regarding the interaction of due-on-sale and prepayment penalty mortgage clauses is section 341 of the Garn-St Germain Depository Institutions Act of 1982.[1] Section 341, in addition to preempting state restrictions on due-on-sale clauses, permits the Office of Thrift Supervision ("OTS"), in consultation with the Comptroller of the Currency and the National Credit Union Administration Board, to adopt uniform rules and regulations governing due-on-sale clauses.

The predecessor of the OTS (Federal Home Loan Bank Board) adopted regulations governing the interaction of due-on-sale clauses and mortgage prepayment penalty provisions. The regulations appeared at 12 CFR 591.5 (1984). The regulations provided that the "due-on-sale practices of Federal associations and other lenders shall be governed exclusively by the Board's regulations…"[2] The regulations expressly provided that lenders other than Federal savings associations "may impose a prepayment charge or equivalent fee

[1] Codified at 12 USC 1701j-3.
[2] 12 CFR 591.5(b)(2)(ii) (1984).

in connection with acceleration of the loan by exercise of due-on-sale clause…"[3] In other words, at one time it was permissible to charge borrowers that prepaid loans in anticipation of due-on-sale acceleration prepayment penalties.[4]

After the adoption of 12 CFR 591.5 (1984), lenders increased their imposition of prepayment penalties on borrowers that prepaid their loans under the lender's threat to invoke a due-on-sale clause and accelerate the loan. "The explanation given for this appears to be an attempt by some lenders to improve their weakened financial condition" resulting from the early payoff of loans.[5]

On August 2, 1984, the Federal Home Loan Bank Board proposed to revise 12 CFR 591.5 (1984) to restrict the authority of lenders to assess prepayment penalties against borrowers that prepay loans upon the sale of the underlying property. The Board's proposal was made in response to Congressional "concern for consumer protection and the unfairness of permitting lenders which have not formally called a loan to achieve the same result by giving notice of an intent to do so and then charging a penalty upon prepayment."[6] The Board determined that "enforcement of a due-on-sale clause simultaneously with the imposition of a prepayment penalty is inequitable" [7] – it is not equitable for a lender that has not formally called a loan to achieve the same result by giving notice of full amount due and assessing a prepayment penalty.

Your letters to the Bureau and the ZZZs clearly indicate that XXXX has given written notice that the loan at issue is subject and payable in full because of a due-on-sale clause, and if the loan is paid early upon the sale of the underlying property a substantial prepayment penalty will incur. This precise scenario prompted Congress to call for amendment of 12 CFR 591.5 (1984).

Under the provisions of 12 CFR 591.5(b)(2)(i) (1999) lenders are prohibited from imposing prepayment penalties once the lender or a party acting on behalf of the lender sends written notice to a borrower that a loan is due pursuant to a due-on-sale clause. Your letters of June 22, 1999, July 15, 1999, and August 16, 1999, all indicate that XXXX is assessing a prepayment penalty in connection with a due-on-sale clause. Therefore, XXXX is prohibited from assessing a prepayment penalty if the ZZZs pay off their loan because the subject property is sold.

---

3 *Id*.

4 Final Rule, Preemption of State Due-on-sale Laws: Imposition of Prepayment Penalties, 50 FR 46744 (November 13, 1985).

5 Proposed Rule, Preemption of State Due-on-sale Laws: Imposition of Prepayment Penalties, 49 FR 32081 (August 10, 1984), and 50 FR 46744, 46747 (1985).

6 50 Fed Reg 46744, 46746 (1985).

7 50 Fed Reg 46744, 46745 (1985).

It is my expectation that XXXX will resolve this matter as soon as possible and thereby eliminate the need for further action in this regard. Additionally, as is the Bureau's normal practice, members of my staff will be happy to answer any question you may have regarding this letter or any other regulatory concern. Please contact Marcia J. Miller regarding your resolution of the ZZZ's complaint. You can reach Ms. Miller at (517) 373-3470.

Sincerely,

/s/

Gary K. Mielock
Acting Commissioner

Cc: Barbara Strefling
DJ Culkar
Marcia Miller

DJ C:\Data\MS-WORD\Correspondence\Prepayment Penalties-Parity Act\