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

January 12, 2000

YYY
XXXX
XXXXXXX
XXXXXXXX

Dear YYY:

This letter is in response to your letter dated November 18, 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 a "3% prepayment penalty will be assessed if this loan is paid in full within the first three years of the loan" to be a very broad generalization that in some cases is unsupportable.

Although XXX's "Adjustable Rate Note" may qualify the loan as an alternative mortgage transaction under the federal Alternative Mortgage Transactions Parity Act and, therefore, preempt the application of Michigan's prepayment penalty restrictions, prepayment penalties may not be assessed where the loan is paid pursuant to a due-on-sale clause. This same reasoning would apply even if the loan did not qualify as an alternative mortgage transaction. Because the "Adjustable Rate Note" contains a due-on-sale clause, the broad statement in your letter that a prepayment penalty will accrue for any prepayment during the first three years is not entirely accurate and is likely to confuse consumers regarding their legal rights and duties.

To explain our disagreement with XXX 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

[1] Codified at 12 USC 1701j-3.

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 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 letter and the complaint filed by ZZZ indicate that the issue is not what the appropriate prepayment penalty is under Michigan or federal law, but rather whether any prepayment can be charged in conjunction with a due-on-sale clause. The ZZZ complaint clearly indicates that the prepayment issue is raised because of a contemplated sale of the underlying real property. Your letter of November 18, 1999 clearly indicates that XXXX is demanding a prepayment penalty. The letters combined present the precise scenario that prompted Congress to call for amendment of 12 CFR 591.5 (1984).

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

---

2 12 CFR 591.5(b)(2)(ii) (1984).

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).

this letter or any other regulatory concern. Please contact Marcia J. Miller regarding your resolution of the ZZZ complaint. You can reach Ms. Miller at (517) 373-3470.

Sincerely,

/s/

Barbara J. Strefling, Director
Licensing and Enforcement Division

Cc: DJ Culkar
Marcia Miller

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