

December 15, 2003

[redacted]

Re: Prepayment Penalties on First and Secondary Mortgage Loans

Dear [redacted]:

This letter responds to your request for a determination by the Pennsylvania Department of Banking (the "Department") of the extent to which a licensee under the Mortgage Bankers and Brokers and Consumer Equity Protection Act ("MBBCEPA"), 63 P.S. § 456.101 *et seq.*, and the Secondary Mortgage Loan Act ("SMLA"), 7 P.S. § 6601 *et seq.*, may charge a prepayment penalty on first and secondary mortgage loans.

As a general matter, the Loan Interest and Protection Law ("LIPL"), 41 P.S. § 101 *et seq.*, prohibits a prepayment penalty at any time before the end of the period of a residential mortgage obligation. *See* 41 P.S. § 405; 10 Pa.Code § 7.8(a). The LIPL is specifically applicable to licensees under the MBBCEPA by virtue of Section 308(a)(5) of the MBBCEPA, which states that a licensee shall:

[c]omply with all provisions of the act of January 30, 1974, (P.L. 385, No. 6), referred to as the Loan Interest and Protection Law, provided, however, that this shall not be deemed an override of section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161, 12 U.S.C. § 1735f-7a).

63 P.S. § 456.308(a)(5).¹ The LIPL does not apply to residential first mortgage loans in bona fide original principal amounts that are greater than \$50,000. *See* 41 P.S. § 301(f)(i).

In addition, a prohibition against prepayment penalties appears in Section 12(a) of the SMLA, which states that "[a] licensee shall permit a borrower to pay partially or wholly any contract or any installment on a contract, without penalty, prior to the due date." 7 P.S. § 6612(a). The definition of "secondary mortgage loan" contained in Section 2 of the SMLA ties the SMLA's applicability to the exceptions to the applicability of the LIPL, stating that a loan which:

. . . is not subject to the maximum legal rate of interest established by section 201 or section 301 of the act of January 30, 1974 (P.L. 13, No. 6), referred to as the

¹ While the Pennsylvania General Assembly did not attempt to override the provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), 12 U.S.C. § 1735f-7a, and therefore some of the provisions of the LIPL are overridden by the application of DIDMCA, regulations promulgated pursuant to DIDMCA specifically state that state law limitations on prepayment penalties are not preempted by DIDMCA. *See* 12 C.F.R. § 590.3(c).

[redacted]

December 15, 2003

Page 2

Loan Interest and Protection Law, by reason of any of the exemptions provided in section 301(f) of said act; . . . shall not be subject to the provision of [the SMLA].

7 P.S. § 6602 (definition of “secondary mortgage loan”). As noted above, Section 301(f)(i) of the LIPL provides that the LIPL does not apply to loans of original principal amounts of greater than \$50,000. *See* 41 P.S. § 301(f)(i). Thus, the SMLA does not apply to secondary mortgage loans of bona fide original principal amounts of greater than \$50,000.

Please be advised that Section 511(f) of the MBBCEPA restricts the ability of MBBCEPA and SMLA licensees to charge prepayment penalties on “covered loans” of up to \$100,000. *See* 63 P.S. § 456.511(f), 456.503 (definition of “covered loan”). However, Section 511(f) of the MBBCEPA does not itself provide authorization for MBBCEPA and SMLA licensees to charge prepayment penalties on residential first and secondary mortgage loans of original principal amounts of \$50,000 or less, regardless of whether such loans are “covered loans” within the meaning of Section 503 of the MBBCEPA. *See* 15 U.S.C. § 1639(c)(2)(D); 12 C.F.R. § 226.32(d)(7) (through 63 P.S. § 456.503 (definition of “covered loan”)).

Based upon the foregoing, a prepayment penalty may not be charged on a residential first or secondary mortgage loan in an original principal amount of \$50,000 or less. However, based upon the applicability of the LIPL and the SMLA, a prepayment penalty may be charged on a residential first or secondary mortgage loan in a bona fide original principal amount that is greater than \$50,000.

This letter shall supercede all prior Department interpretations which permitted MBBCEPA and SMLA licensees to charge prepayment penalties on residential first and secondary mortgage loans of original principal amounts of \$50,000 or less based upon regulations promulgated under the Alternative Mortgage Transaction Parity Act of 1982 (“AMTPA”), 12 U.S.C. § 3801 *et seq.* Specifically, such regulations permitted MBBCEPA and SMLA licensees that qualified as “housing creditors” under AMTPA to charge prepayment penalties on mortgage loans that qualified as “alternative mortgage transactions” pursuant to 12 C.F.R. § 560.220 (through 12 C.F.R. § 560.34), regardless of state law prohibitions to the contrary. Since 12 C.F.R. § 560.220 has been amended to remove the applicability of 12 C.F.R. § 560.34 to non-depository housing creditors engaging in alternative mortgage transactions, *see* 67 Fed.Reg. 60542, 76304, MBBCEPA and SMLA licensees may no longer avail themselves of the authority contained in AMTPA regulations in order to charge prepayment penalties on residential first and secondary mortgage loans of original principal amounts of \$50,000 or less that qualify as alternative mortgage transactions.

Finally, in response to your query regarding the “specific restrictions on the terms used in the mortgage contract (Note) for the State of PA,” please be advised that all such contracts must comply with the terms and restrictions required by the LIPL, MBBCEPA and/or SMLA, and any applicable federal law.

The Department’s analysis is based upon the facts as stated in this letter. Any change in the facts could result in an amendment or reversal of the Department’s position. This letter has been

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December 15, 2003

Page 3

authorized by the appropriate Department personnel and constitutes a duly authorized statement of the Department's position regarding the issues discussed herein. This letter may not be relied upon or construed as constituting legal advice.

Please do not hesitate to contact me if you have any further questions regarding this matter.

Sincerely,

Carter D. Frantz
Staff Counsel

cc: Cynthia G. Wirt
Director, Bureau of Licensing, Compliance and Consumer Services

Victor H. Seesholtz
Manager, Compliance Division