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UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA - SACRAMENTO DIVISION

QUICKEN LOANS INC., a Michigan corporation, *Plaintiff*, *v.* DEMETRIOS A. BOUTRIS, in his official capacity as Commissioner of the California Department of Corporations, *Defendant*.	Case No. S-03-256 GEB JFM (Related to case S-03-157 GEB JFM) **(1) NOTICE OF MOTION AND MOTION FOR PARTIAL SUMMARY JUDGMENT AND PERMANENT INJUNCTION;** **(2) MEMORANDUM OF POINTS AND AUTHORITIES** [attached hereto]; **(3) STATEMENT OF UNDISPUTED FACTS** [submitted herewith under separate cover]; and **(4) DECLARATION OF PATRICK MCINNIS** [submitted herewith under separate cover] Date Filed: February 11, 2003 Trial Date: t/b/d Hearing Date: April 7, 2003 Hearing Time: 9 a.m. Hon. Garland E. Burrell (Courtroom 10)

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TO DEMETRIOS A. BOUTRIS AND HIS COUNSEL OF RECORD:

Please take notice that on April 7, 2003, in the courtroom of the Honorable Garland E. Burrell, Jr., located at 501 I Street, Sacramento, California 95814 at 9 a.m., Plaintiff Quicken Loans Inc. ("Quicken Loans") will and hereby does move this Court for an order granting Quicken Loans partial summary judgment and a permanent injunction preventing the Commissioner of the California Department of Corporations (the "Commissioner"), and any other agent of the State of California, from enforcing the "per diem" interest restrictions found in the current and previous version of California Civil Code section 2948.5 as well as California Financial Code Section 50204(o), as to residential mortgage loans made by Quicken Loans that either qualify under the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), or are made pursuant to the Alternative Mortgage Transaction Parity Act of 1982 (the "Parity Act"), or are covered by both statutes.

This Motion is made on the grounds that the DIDMCA or the Parity Act or both preempt California's "per diem" statutes as to Quicken Loans' mortgage loans qualifying under the DIDMCA and the Parity Act. This Motion is based on this Notice of Motion and Motion, the attached Memorandum of Points and Authorities, the accompanying statement of undisputed facts, the declaration of Patrick McInnis, the pleadings filed in this action, and such other argument, authority, and evidence that this Court may consider.

Dated: March 10, 2003

KIRKPATRICK & LOCKHART LLP

Edward P. Sangster
Matthew G. Ball
Attorneys for PLAINTIFF

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

This is an action for declaratory and injunctive relief. Plaintiff Quicken Loans Inc. ("Quicken Loans") is a residential mortgage lender that seeks to invalidate the application of California's "per diem" statutes to Quicken Loans on the grounds that they are preempted by federal law. The per diem statutes prohibit the collection of interest prior to recordation of a mortgage or, in the case of an earlier statute, prior to close of escrow. Quicken Loans contends that the "per diem" statutes are expressly preempted by two federal laws, Section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA") and the Alternative Mortgage Transaction Parity Act of 1982 (the "Parity Act").[1]

II. SUMMARY OF ARGUMENT

DIDMCA expressly preempts state statutes limiting the rate or amount of interest that mortgage lenders may charge on first-lien residential mortgage loans, such as the loans made by Quicken Loans. California's per diem statutes that prohibit lenders from collecting interest prior to recordation of the mortgage are limitations on the interest Quicken Loans may charge and are, therefore, preempted by DIDMCA.

The Parity Act expressly preempts state statutes that restrict the lending activities of nonfederally chartered housing creditors making "alternative mortgage transactions." In essence, the Parity Act prohibits states from imposing restrictions on nonfederally chartered housing creditors, such as Quicken Loans, that may not be imposed on federally chartered creditors, such as federal savings associations. Because the per diem statutes are unenforceable as to federally chartered creditors pursuant to Office of Thrift Supervision

[1] On February 28, 2003, before the Commissioner had served its answer to Quicken Loans' complaint, Quicken Loans amended its complaint to state a claim for declaratory and injunctive relief on the ground that the per diem restriction constitutes an unlawful taking. Quicken Loans does not move for summary judgment on that claim at this time.

("OTS") regulations, they are also unenforceable as applied to Quicken Loans. Accordingly, the Parity Act preempts the per diem statutes.

III. FACTS

A. Background.

Quicken Loans is a lender based in Michigan. It makes a variety of mortgage loans secured by residential real property, including home purchase money, refinancing, and home equity loans. Statement of Undisputed Facts ("SUF") 1. During 2001 and 2002, Quicken Loans made approximately $500 Million and $745 Million, respectively, in loans secured by mortgages on California property. Id.

Borrowers typically contact Quicken Loans over the Internet or via an 800 telephone number that they find on Quicken Loans' Internet website. Declaration of Patrick McInnis ("McInnis Decl.") ¶ 4. After Quicken Loans approves a loan, Quicken Loans and its California borrowers typically complete the lending process through independent escrow companies or through title companies that also serve as escrow companies. Id Quicken Loans deposits the funds for the loan into the escrow. Id. The borrower delivers the executed loan documents to the escrow company, including the deed of trust through which Quicken Loans obtains its security interest in the borrower's property. Id. When the conditions required to close the transaction have been satisfied, the escrow company is instructed by Quicken Loans to disburse the funds to or on behalf of the borrower, and to deliver the deed of trust to the County Recorder's office for recordation in the public records. Id. Quicken Loans causes the recordation of the deed of trust in the public records to place the public on notice of Quicken Loans' security interest in the property, thereby preventing the borrower or others from impairing Quicken Loans' security – either through sale of the property or placement of additional mortgages on the property. Id.

This lawsuit is the result of occasional delays between (a) the disbursement of loan funds to the borrower and (b) recordation of the deed of trust. The escrow company frequently is able to record the deed of trust on the same day that it has disbursed the loan funds to the borrower. Occasionally, however, there is a delay of days, weeks, or even months. SUF 6. Sometimes, the title company fails to deliver the deed of trust to the County Recorder's office on the day that the borrower received the money. Other times, the title company delivers the deed of trust to the County Recorder's office for recordation, but the County Recorder is slow to record the deed. SUF 7.

While Quicken Loans attempts to ensure that its deeds of trust are recorded the same day as funds are disbursed, these delays in recording nevertheless occasionally occur. Regardless of the cause or length of the delay, the borrower has already received his or her money. Despite this, California's per diem statutes purport to prohibit lenders from charging interest until one day prior to the day the deed of trust has been recorded. The "per diem" statute the Commissioner asserts is currently applicable to Quicken Loans is Financial Code § 50204(o) ("Section 50204(o)"), which provides in relevant part:

> A licensee may not . . . [r]equire a borrower to pay interest on the mortgage loan for a period in excess of one day prior to recording of the mortgage or deed of trust.

Quicken Loans historically has instructed the escrow company to assess a borrower interest commencing on the date the escrow company disburses the loan funds directly to the borrower, or to a third party on the borrower's behalf. SUF 10. As discussed below, the Commissioner is threatening to penalize Quicken Loans as a result of this practice. SUF 11 & 12.

To a limited extent, this lawsuit also concerns an earlier version of California's per diem statutes. The other per diem statute that the Commissioner asserts was applicable to Quicken Loans until January 1, 2001, is an earlier version of California Civil Code § 2948.5 ("Section 2948.5") (subsequently amended), which provided in relevant part:

> [i]nterest on the principal obligation of a promissory note secured by a mortgage or deed of trust on real property improved with one-to-four residential dwelling units shall not commence to accrue prior to close of escrow if the loan proceeds are paid into escrow or, if there is no escrow, the date upon which the loan proceeds have been made available for withdrawal as a matter of right, as specified in subdivision (d) of Section 12413.1 of the Insurance Code.

Thus, Section 2948.5 barred the collection of "per diem" interest on funds deposited into escrow before the "close of escrow." While the phrase "close of escrow" is not defined in the statute, it appears the Commissioner is taking the position that this equates to the standard set forth in Section 50204(o), i.e., recordation of the deed of trust.

As discussed below, the Commissioner is trying to force Quicken Loans to spend hundreds of thousands of dollars proving that it did not violate Section 50204(o) or Section 2948.5.

B. The Commissioner's Threats to Penalize Quicken Loans for Alleged Violations of the Per Diem Statutes.

The California Residential Mortgage Lending Act ("California RMLA"), California Financial Code §§ 50002 et seq., required Quicken Loans to obtain a license from the Commissioner of the Department of Corporations in order to make loans secured by real property located in California. Quicken Loans obtained such a license. SUF 2. In accordance with Financial Code § 50302, the Commissioner may examine the books and records of RMLA licensees.

On March 11, 2002, the Commissioner sent a letter to Quicken Loans detailing the Commissioner's most recent examination of Quicken Loans' operation. Among other things, the Commissioner asserted that Quicken Loans was violating the "per diem" restriction found in Sections 2948.5 and 50204(o). SUF 11. The Commissioner ultimately ordered Quicken Loans to: (1) review all loans made in California from a period beginning October 14, 1999; (2) refund interest payments collected in violation of the "per diem" restrictions (with 10% interest); and (3) submit a detailed report of all such loans, which report was to include the loan number, borrower's name, loan amount, interest rate, date recorded, interest start date, amount of interest collected/credited on HUD-1, first payment due date, correct amount of interest, amount overcharged, amount refunded and date refunded. SUF 12. The Commissioner has threatened unspecified enforcement action if Quicken Loans should refuse. SUF 13.

To effect the review and complete the report the Commissioner has ordered would require the review of approximately 5,500 files. Quicken Loans estimates the cost for this at approximately $400,000. SUF 14. While Quicken Loans is not certain of the exact amount of refunds it would be required to make pursuant to the Commissioner's demand Quicken Loans estimates refunds would total hundreds of thousands of dollars at a minimum, and potentially millions of dollars. SUF 15.

IV. ARGUMENT

A. Federal Law Preempts Certain Aspects of State Laws Regulating Mortgages.

The federal Constitution directs that "the Laws of the United States . . . shall be the supreme Law of the Land . . .; any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Thus, if Congress so intends, it has the power to preempt state laws that conflict with federal laws. Crosby v. National Foreign Trade Council, 530 U.S. 363, 372 (2000); Bank of America v. City and County of San Francisco, 309 F.3d 551, 557-58 (9th Cir. 2002). Not only may Congress preempt state law, but a valid federal regulation intended to displace state law has no less preemptive effect than a federal statute. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1982).

This case involves so-called "express preemption," in which Congress has defined explicitly the extent to which its enactments preempt state law. Id.; accord, e.g., Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 31 (1996); Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992); Bank of America, 309 F.3d at 558. The preemption arises from DIDMCA and the Parity Act.

B. DIDMCA Expressly Preempts the Per Diem Statutes.

"Congress enacted DIDMCA to promote the stability and viability of financial institutions by allowing them to charge market interest on mortgage loans, and to promote home ownership by increasing the flow of available mortgage money." Brown v. Investors

Mortgage Co., 121 F.3d 472, 475 (9th Cir. 1997) (citing Smith v. Fidelity Consum :r Discount Co., 898 F.2d 907, 911-12 (3rd Cir. 1990)).

To that end, Section 501(a) of the DIDMCA provides that "the constitution or laws of any State" which "expressly limit[] the rate or amount of interest . . . which may b : charged . . . **shall not apply**" to any loan or mortgage which is:

- "secured by a first lien on residential real property";
- "made after March 31, 1980"; and
- is a "federally related mortgage loan."

12 U.S.C. §§ 1735f-7a(a)(1) (emphasis added).[2]

A "federally related mortgage loan" is a loan that is secured by residential real property, and is made by a party who qualifies as a "creditor" under the Federal 'ruth in Lending Act ("TILA"), and who makes or invests in residential real estate loans a jgregating more than $1 million per year. 12 U.S.C. §§ 1735f-7a(a)(1); 1735f-5(b)(1) & 2(D . To qualify as a "creditor" under TILA, a party must regularly extend consumer credit and must be the person to whom the debt is initially payable. 15 U.S.C. § 1602(f). Quicke n Loans' sole business is making residential mortgage loans. In fact, it originated in exce ;s of $7 Billion in such loans in 2002. All of those loans were made payable to Quicken l oans as the creditor. SUF 3.

A federal court in Michigan has already held that DIDMCA preempted tha : state's version of a per diem statute. In Shelton v. Mutual Savings and Loan, 738 F. Su op. 1050 (E.D. Mi. 1990), the issue was whether the DIDMCA preempted a Michigan state statute barring the assessment of interest before the lender disbursed funds to the borr wer. Id. at 1058. Noting that "the broadest possible interpretation of the exemption from st ite usury

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[2] DIDMCA allowed the states to override this express preemption of state limits on residential mortgage interest and fees, but a state had to exercise this authority prior to April 1, 1983, and it had to do so by making explicit reference to 12 U.S.C. § 17:5f-7a(a)(1). California did not explicitly opt out of this provision of DIDMCA within the specifie d time period.

laws is consistent with the legislative purpose" of DIDMCA, the court held that DIDMCA preempted the statute.

Not surprisingly, federal regulatory agencies have consistently agreed that DIDMCA preempts per diem and other, similar statutes. In 1987, the Federal Home Loan Bank Board ("FHLBB") opined that a Maryland statute barring lenders from assessing "odd days interest" was preempted under DIDMCA. "Odd days interest" is interest computed on a per diem basis from the time the loan closes until the beginning of the first full month after closing. McInnis Decl. ¶ 8. "Odd days interest" is generally payable at closing in order to allow lenders to recite, in promissory notes, even monthly installments of principal and interest. Id. The General Counsel of the FHLBB concluded that "odd days interest" was "interest" for purposes of the DIDMCA, and, that in light of the time value of money, the Maryland statute operated as a limitation on the amount of interest a lender could charge. See FHLBB Office of General Counsel Opinion Letter (Quinlan, May 8, 1987), 1987 FHLBB LEXIS 65, attached hereto as Exhibit A.[3] Shortly after the FHLBB issued its letter, the Office of the Maryland Attorney General issued an opinion letter reaching the same conclusion. 73 Op. Att'y Gen. 144 (April 5, 1988), 1988 Md. AG LEXIS 19, attached hereto as Exhibit B.

Regulatory agency opinion has not changed. In the case related to this matter, Wells Fargo Bank, N.A., et al. v. Boutris, S-03-0157 GEB JFM, the Office of Comptroller of the Currency (the "OCC") filed an amicus curiae brief arguing that California's per diem statutes are preempted by DIDMCA. As the agencies charged with issuing regulations and

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[3] Quicken Loans respectfully requests this Court to take judicial notice of this and other administrative records attached to this Memorandum of Points and Authorities. See Mack v. South Bay Beer Distrib., Inc., 798 F.2d 1279, 1283 (9th Cir. 1986) ("a court may take judicial notice of records and reports of administrative bodies") (internal quotation omitted) abrogated on other grounds by Astoria Fed. Sav. & Loan Ass'n v. Solimino, 501 U.S. 104 (1991).

interpretations relating to this portion of DIDMCA, the opinions of the OTS (forme rly the FHLBB[4]) and OCC are entitled to "great weight." See Bank of America, 309 F.3(at 563.

In the related case, the Commissioner argued in opposition to Wells Farg)'s motion for preliminary injunction that Shelton never reached preemption of the statute al issue. That is wrong. On page 1057, as well as page 1058, the very page cited by the Commissioner, the district court held: "Therefore, the broadest possible interpre ation of the exemption from state usury laws is consistent with the legislative purpose [of DIL MCA]. That being the case, the Court holds that Section 1735f-a does preempt M.C.L. § 438.31c(9). Even though the Court has found preemption, it will nevertheless ac dress the issues it believes are raised by Plaintiffs with respect to their interpretation of Se tion 438.31c(9)." Thus, the Commissioner's attempt to distinguish Shelton gives new meaning to the word "wrong."

The Commissioner also argued that Grunbeck v. Dime Savings Bank of N ew York, FSB, 74 F.3d 331 (1st Cir. 1996), controlled, and that DIDMCA therefore did not preempt the per diem statutes. At the outset, it should be noted that Grunbeck did not involve anything remotely similar to the per diem statute. When the lender in Grunbeck sued to c ollect deficiencies on the note, the borrower argued that the manner in which the lende r had calculated interest – charging compound interest rather than simple interest – vic lated a New Hampshire statute requiring that only simple interest be charged. The distr ct court agreed that DIDMCA preempted the simple interest statute, but the court of app eals

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[4] The FHLBB's functions were transferred to the OTS pursuant to The Financial nstitutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Pub. L. No. 101-73, 103 Stat. § 183, 356-357 (1989), codified at 12 U.S.C. § 1462a. In a 1994 OTS opinion le ter, the OTS' Deputy Chief Counsel stated "Opinions of the former FHLBB constitute val d and binding precedent for savings associations unless or until modified or revoked by the Office of Thrift Supervision." OTS Op. by Solomon (September 29, 1994), 1994 OTS LEXIS 37, attached hereto as Exhibit C.

reversed. The court of appeals concluded that DIDMCA did not preempt the sirr ple interest statute because it did not "expressly limit the rate or amount of interest." Id. at 3 37-38. The court of appeals observed that the lender was free to charge whatever interest r te it wanted. According to the court of appeals, the lender could have collected just s much interest by charging a higher, simple interest rate; thus, the simple interest statut did not restrict either the rate or amount of interest. Id. at 339-40.

Not only is Grunbeck wrongly decided on this issue, it is not binding and i factually distinguishable. California's per diem statute contains an express prohibition on the amount of interest that lenders may charge. It commences with the express limitation th t "a borrower shall not be required to pay interest . . . ." Cal. Civ. Code § 2948.5(a) (Vest 2003). Moreover, unlike New Hampshire's simple interest statute, Quicken Loans cann t compensate by charging a higher interest rate; once the escrow has closed, Qui ken Loans has no way of making up for interest lost by delays in recording the deed of trust SUF 8 & 9. Thus, unlike the law at issue in Grunbeck, limiting the amount of interest rea zable to Quicken Loans is not an incidental effect of the per diem statutes; it is the very p rpose of the per diem statutes.

Furthermore, the court of appeals in Grunbeck was expressly influenced y consumer protection concerns that do not apply to the per diem statutes. The c urt of appeals held that the ban against compounding interest protected borrowers ag inst "unseen" costs and the silent erosion of home equity. 74 F.3d at 340. Assumin , for the sake of argument only, that the Grunbeck court was correct on this point, no suc concerns exist for California's per diem statute. The borrowers have all the money they b rgained for, and have full use of the funds on the date that interest commences accruing. T us, the statutory construction and policy concerns that supported the decision Grunbeck do not apply to California's per diem statutes.

Because California's per diem statutes impermissibly restrict the interest that can be charged on federally related mortgage loans, they are preempted by DIDMCA and are unenforceable.

C. <u>The Parity Act Preempts the Per Diem Statutes With Respect to Quicken Loans' "Alternative Mortgage Transactions" Because the Per Diem Statutes Cannot Be Enforced Against Federally Chartered Lenders.</u>

The Parity Act provides that nonfederally chartered lenders may make variable-interest home mortgage loans and other "alternative mortgage transactions" on the same terms as federally-chartered lenders, "notwithstanding any State constitution, law, or regulation." 12 U.S.C. § 3803(c). An "alternative mortgage transaction" essentially means a mortgage transaction with terms that differ from a traditional fixed-rate, fixed-term mortgage. <u>See</u> 12 U.S.C. § 3802(1); <u>First Gibraltar Bank, FSB v. Morales</u>, 19 F.3d 1032, 1037 (5th Cir. 1994) ("alternative mortgage transactions" means "all manner of mortgage instruments that do not conform to the traditional fully-amortized, fixed-interest-rate mortgage loan."), <u>vacated on other grounds and superseded by</u> 42 F.3d 895 (5th Cir. 1995). An adjustable rate mortgage loan that allows the interest rate to vary would be an example of an "alternative mortgage transaction." Thus, for all alternative mortgage transaction loans (including those that are not first-lien loans), the Parity Act preempts the per diem statutes.

The per diem statutes cannot be enforced against federally chartered lenders. In <u>Washington Mutual Bank, F.A. v. Superior Court</u>, 95 Cal. App. 4th 606 (2002), a plaintiffs' class sued a federally chartered lender, alleging that its policy of requiring borrowers to pay interest prior to closing violated Section 2948.5 and other state laws. The lender demurred, arguing that Section 2948.5 and other laws were preempted by the Home Owners' Loan Act ("HOLA"), 12 U.S.C. §1461 <u>et seq</u>., and OTS regulations issued pursuant to HOLA. When the Superior Court overruled the demurrer, the lender filed a petition for a writ of mandate directing the trial court to sustain the demurrers without leave to amend. The court of appeal reversed, and granted the extraordinary relief. The court of appeal held that the per diem statute was preempted by federal law. <u>Id.</u> at 621 ("We find that preemption of state law claims, premised on the theory that the charging of pre-closing interest by a ederal savings and loan association is unlawful, is explicit by virtue of the provisions of 2 Code of Federal Regulations section 560.2 which expressly preempts any state law gove ning the lending operations of a federal savings institution.")

Because the per diem statute is preempted as to federally chartered lend ers, it is likewise preempted as to nonfederally chartered lenders such as Quicken Loans

In Illinois Association of Mortgage Brokers v. Office of Banks and Real Es tate, 308 F.3d 762 (7th Cir. 2002), an association of mortgage lenders challenged state re ulations imposing restrictions on balloon payments, prepayment penalties, and amortizat on schedules that could not be applied to federally chartered lenders. The district c ourt ruled that a 1994 amendment impliedly repealed the parity provisions in the Parity Act and the court of appeals reversed on two grounds. First, the court of appeals rejected th e argument that the parity provisions had been impliedly repealed. Second, it held that the P arity Act preempted the state regulations. "*If* a given transaction is an 'alternative mortga ge transaction' – that is, if it is a variable-rate home equity loan that a federal lender could make under OTS regulations – then *all* state rules regulating that loan are preem pted to the extent required for parity." Id. at 767-68 (emphasis in original). Thus, "State len ders get to do what federal lenders are allowed to do, by federal statutes and OTS regulatic ns." Id. at 766.

Similarly, in National Home Equity Mortgage Association v. Face, 239 F.3d 633 (4th Cir. 2001), the plaintiff argued that the Parity Act preempted Virginia statutes prc hibiting the collection of prepayment penalties. The district court granted summary judgmer t, and the court of appeals affirmed. The court of appeals held that nonfederally chartered lenders could charge prepayment penalties because federally chartered lenders could d o so. Id. at 638.

Here, the OTS has issued regulations broadly occupying regulation of the terms of credit offered to borrowers:

> To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. . . . Accordingly, federal savings associations may extend credit as authorized under federal law . . . without regard to state laws purporting to regulate or otherwise affect their credit activities . . . .

Section 560.2(b) provides examples of state laws that are preempted, including b)(4), which specifically lists laws affecting "[t]he terms of credit . . . ."

Section 560.2 is certainly broad enough to preempt California's per diem statutes, as the California Court of Appeal has specifically held in a decision analyzing the former per diem restriction found in the pre-2001 version of Section 2948.5:

> Charging interest and disbursing loan proceeds, we conclude, fall within the 'terms of credit' as that phrase is used in paragraph (b)(4) of 12 Code of Federal Regulations section 560.2. The date interest begins to accrue and who pays it are as much terms of credit as [other laws mentioned in (b)(4)] since all of these items center around the essential reason lenders issue home loans, to wit, charging and collecting interest.

Washington Mut. Bank, supra, 95 Cal. App. 4th at 621.

Thus, the Parity Act preempts application of California's per diem statutes to Quicken Loans because those statutes cannot be applied to federally chartered lenders.

One case dealing with unrelated provisions of California law adopted a more restrictive interpretation of the preemptive effect of the Parity Act, but the circumstances were so different that it lacks meaningful application to this case. In Black v. Financial Freedom Senior Funding Corp., 92 Cal. App. 4th 917 (2002), the plaintiffs were an elderly couple who sued a lender, challenging the adequacy and completeness of disclosures and representations in connection with a "reverse mortgage." That case, however, was based on the principle that federal banking law does not preempt state law fraud and deceptive advertising claims.[5]

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[5] See, e.g., People ex rel. Sepulveda v. Highland Fed. Sav. & Loan 14 Cal. App. 4th 1692, 1712 (1993) (no preemption of state law claims against a federal savings association for

CONCLUSION

A permanent injunction is an appropriate remedy where the court concludes on summary judgment that federal banking law preempts a state statute. See Bank of America, 309 F.3d at 566. Because the per diem statutes are preempted as to loans covered by the DIDMCA, and loans made pursuant to the Parity Act, this Court should grant Quicken Loans' motion for partial summary judgment, and enter the requested permanent injunction.

Dated: March 10, 2003

KIRKPATRICK & LOCKHART LLP

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Attorneys for PLAINTIFF

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engaging in transactions with straw men in order to frustrate enforcement of the state's habitability law); Fenning v. Glenfed, Inc. 40 Cal. App. 4th 1285 (1995) (action for unfair and deceptive trade practices not preempted); see also Lopez v. World Sav. & Loan Ass'n., 105 Cal. App. 4th 729 (2003) (distinguishing deceptive advertising cases from regulation of fees, and holding that state law regulating amount of charge for faxing payoff demand was preempted).

EXHIBIT A

Citation # 2
1987 fhlbb lexis 165

FEDERAL HOME LOAN BANK BOARD

1987 FHLBB LEXIS 165

May 8, 1987

Dear [***]:

The Office of General Counsel ("OGC") of the Federal Home Loan Bank Board ("Bank Board") has recently received letters from several law firms requesting an interpretive ruling pursuant to Section 501(f) of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("Act"), 12 U.S.C.A. § 1735f-7 note (West 1980 & Supp 1986), regarding the effect of the State of Maryland's recent amendment to Section 1 -103(b) of the State's Commercial Law Code on Federally-related residential mortgage loans. This Office has been asked to concur in the view that Section 501(f) of the Act preempts this recent amendment as an express limitation on the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, or received with respect to a Federally-related loan. In this opinion, I will refer o the regulations promulgated by the Bank Board under the Act, rather than to the pertinent provisions of the Act. 12 C.F.R. Part 590 (1986).

Section 12-103(b) of the Maryland Commercial Code ("Commercial Code") provides that for loans secured by residential real property, a lender may charge interest "at any effective rate of simple interest on the unpaid principal balance of a loan" if, inter alia, there is a written agreement signed by the borrower which sets forth the rate of interest charged, there is no prepayment penalty in connection with the loan, and the loan is secured by a first mortgage or first deed of trust. Md. Com. Law Code Ann. § 12-103( ) (1983 & Supp. 1986). This section, as recently amended by Senate Bill 393, provides that as an additional prerequisite to a lender's charging of any effective rate of interest, such lender cannot "require payment of any interest in advance except any points permitted under this subtitle." Id. § 12-103(b)(vi).

Section 590.3(a) of the Bank Board's regulations states the general rule for preemption of state usury laws applicable to Federally-related loans:

The provisions of the constitution or law of any state expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any Federally-related loan:

(1) Made after March 31, 1980; and

(2) Secured by a first lien on:

(i) Residential real property. . . .

12 C.F.R. § 590.3(a) (1986). Section 590.3(c) provides further:

Nothing in this section preempts limitation[s] in state laws on prepayment charges; attorney's fees, late charges or other provisions designed to protect borrowers.

Id. § 590.3(c).

The Act was enacted in response to Congressional concerns that where state usury la\ 's required mortgage rates below market levels of interest, mortgage funds in those stat :s would not be readily available. Moreover, in addition to the need to address the adver .e effects of usury ceilings on credit availability, mortgage interest rate ceilings were removed to permit savings and loan associations to begin paying market rates of inte ;st on savings deposits.

The legislative history of the Act clearly identifies the state usury limitations from whic n the Act sought to exempt Federally-related mortgage loans:

In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fe s, late charges, or similar limitations designed to protect borrowers.

S. Rep. No. 368, 96th Cong., 2d Sess. 19, reprinted in [1980] U.S. Code Cong. & Ad. News 236, 255. Prior opinions issued by this Office, citing this legislative history, have concluded that with respect to Federally-related residential mortgage loans, Congress intended to preempt all provisions of state law limiting interest charges and other charges includable in the annual percentage rate. OGC Usury Preemption Opinions No: . 91, 19 (February 4, 1986; August 5, 1980).

Regulation z, which implements the Truth in Lending Act, 15 U.S.C. § 1601 et seq., defines the annual percentage rate as "a measure of the cost of credit, expressed as a yearly rate." 12 C.F.R. § 226.22 (1986). "Finance charges," which are included within :he annual percentage rate, are defined to include "interest, time price differential, and ar y amount payable under an add-on or discount system of additional charges." Id. §§ 22 .4 (a), (b).

It is the conclusion of this Office that the prepaid or "odd days" interest addressed by he recent amendment to Maryland's Commercial Code is "interest" under the Act, and th t in light of the time value of money, this amendment to the Commercial Code operates as a limitation on the amount of interest charged on a Federally-related loan. Such intere st is calculated on the basis of the interest rate applied to the full term of the loan, but is obviously only applied to that fraction of a month that follows the date of closing. The shorter term to which this rate is applied for purposes of computing the prepaid intere :t due does not change the nature of the charge itself; it remains interest. n1

n1 This conclusion does not overlook section 226.17(c)(4) of Regulation z, which provides that in making calculations and disclosures, first period irregularities may be disregarded in the annual percentage rate in specified instances. Prepaid interest is nevertheless includable in the annual percentage rate in such instances, and dependin } upon the term of the loan, may be required to be included in the annual percentage r te. See 12 C.F.R. § 226.17(c)(4) (1986).

I also note that the Commercial Code, which sets forth a general definition of "interest," neither distinguishes nor separately defines "prepaid interest." Compare Md. Com. Law Code Ann. § 12-101(e) with § 12-103(b)(vi).

The DIDMCA and the Bank Board's implementing regulations preclude a state from limiting the rate or amount of interest that may be charged, taken, received, or reserved regarding Federally-related loans unless the state, on or before April 1, 1983 (and after April 1, 1980), had adopted a law or had certified that the voters of such state had voted in favor of any law which "states explicitly and by its terms" that such state does not want the Federal usury preemption to apply. 12 C.F.R. § 590.3 (1986). There is no evidence that the State of Maryland has enacted such legislation or otherwise overridden the usury preemption. Thus, it is the opinion of this Office that the Act preempts Maryland's recent amendment to Section 12-103(b) of the Commercial Code limiting the ability of a lender to require payment of interest in advance on a Federally-related residential mortgage loan. n2

n2 I also conclude, consistent with the views expressed in letters received from Maryland's Office of the Attorney General and others, that on the basis of its legislative history, the recent amendment to Section 12-103(b) does not impose any limitation on "points" for federally related loans secured by first liens on residential property, in violation of the Act.

This Office also received one letter seeking our concurrence in the view that Sections 12-109.2(b) and 12-121(b) of the Commercial Code are preempted by the Act. Section 12-109.2(b) provides that a lender or its assignee "may not impose a collection fee or service charge on the maintenance of an escrow account on a first mortgage or first deed of trust." Md. Com. Law Code Ann. § 12-109.2(b) (1983 & Supp. 1986). Section 12-121 (b) provides that "a lender may not impose a lender's inspection fee in connection with a loan secured by residential real property" unless the inspection is needed to ascertain completion of construction of a new home or completion of repairs, alterations, or other work required by the lender. Id. § 12-121(b).

As previously noted, the legislative history of the Act and prior OGC opinions indicate that with respect to Federally-related residential mortgage loans, Congress intended to preempt all provisions of state law limiting interest charges and other charges includable in the annual percentage rate. The letter received seeking our concurrence that sections 12-109.2(b) and 12-121(b) are preempted asserted that such inspection fees and collection/service fees are "charges akin to service fees and loan fees," without any further citation to Regulation z or further arguments. Absent more specific arguments and/or documentation establishing that these charges are includable in the annual percentage rate (e.g., an opinion from the Federal Reserve Board as to whether such charges are includable), and arguments as to why the Maryland statute is not consistent with Section 590.3(b)(3) of the Bank Board's regulations, citing state legislative history, I am reluctant to conclude that Sections 12-109.2(b) and 12-121(b) of the Commercial Code are preempted by the Act. n3 Should the State or other interested parties choose to address these issues more specifically, this Office will carefully weigh such arguments and issue a responsive opinion.

n3 Through informal discussion with the staff of the Federal Reserve Board, this Office has learned that a "lender's inspection fee" is similar to the "appraisal fee" specifically excluded from the definition of "Finance Charge" under Regulation Z, and is thus likely to be excluded from the annual percentage rate. See 12 CFR § 226.4(c)(7)(ii), and Staff Commentary (1986). It is less clear whether the escrow fee or service charge is excluded under section 226.4. Such exclusion may depend upon whether the fee or charge is an ongoing charge, or a one-time charge for setting up the escrow account.

Sincerely,

(signed)
Harry W. Quillian
General Counsel

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EXHIBIT B

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Citation #3
1988 md.ag lexis 19

OFFICE OF THE ATTORNEY GENERAL OF THE STATE OF MARYLAND
Opinion No. 88-020

1988 Md. AG LEXIS 19; 73 Op. Atty Gen. 144

April 5, 1988
CORE TERMS: lender, mortgage, odd, federal preemption, effective, borrower, usury laws, override, preempted, housing, federal law, amount of interest, residential, prepayment, discount, finance charge, lending, payment of interest, Laws of Maryland, residential property, designed to protect, simple interest, market rate, preemption, manufactured, finance, annual percentage rate, first mortgage, residential real property, federal government

FINANCIAL INSTITUTIONS - FIRST MORTGAGE LOANS - FEDERAL PREEMPTION - MARYLAND STATUTE PROHIBITING A LENDER FROM REQUIRING ADVANCE PAYMENT OF INTEREST IS PREEMPTED BY FEDERAL LAW.

Mr. William Beans, Director
Home Ownership Programs
Community Development Administration
Department of Housing and Community Development
45 Calvert Street
Annapolis, Maryland 21401**OPINIONBY:** J. Joseph Curran, Jr., Attorney General; C. Messerschmidt, Assistant Attorney General

OPINION: Your have requested our opinion on whether § 12-103(b)(1)(vi) of the Commercial Law Article ("CL" Article), which prohibits a lender from requiring advance payment of interest on a first mortgage loan, has been preempted by § 501 of the federal Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"). n1

n1 DIDMCA § 501 has never been codified, but is found in a note following 12 U.S.C. § 1735f-7.

For the reasons given below, we conclude that the State law provision has been preempted by federal law and, accordingly, lenders who make loans secured by first mortgages on residential property to which the DIDMCA applies may not be prohibited from collecting interest in advance at the time of loan closing. n2

n2 We thus concur in the views expressed by the General Counsel for the Federal Home Loan Bank Board. Letter from Harry W. Quillan, General Counsel, to Assistant Attorney General Francis X. Pugh (May 8, 1987).

I

Background

The Community Development Administration ("CDA") issues tax-exempt mortgage revenue bonds to finance the purchase of homes by first-time homeowners at rates of interest below the market rate. CDA relies upon financial institutions around the State for the origination and closing of these mortgage loans, and it provides these lenders with mandatory loan closing documents that conform to legal requirements.

Maryland law generally sets limits on the effective rate of simple interest that lenders may charge for various types of loans. n3 However, CL § 12-103(b)(1) permits lenders to charge "interest at any effective rate of simple interest" on a loan secured by a first mortgage or first deed of trust on residential real property, under certain circumstances. By that exception, mortgage lenders are allowed to charge interest at the market rate, but are required to conform their loans to stated conditions. One of those conditions is that "[t]he lender does not require payment of any interest in advance except any points permitted under this subtitle ['Interest and Usury']." CL § 12-103(b)(1)(vi). n4 That condition was added by Chapter 628 of the Laws of Maryland 1986.

n3 "Effective rate of simple interest' means the yield to maturity rate of interest received or to be received by a lender on the face amount of a loan," except that any interest charged at or before the inception of a loan contract is deducted from the face amount to determine the principal of the loan, for the purpose of calculating the effective rate of simple interest. CL § 12-101(d).

n4 "Point' means a fee, premium, bonus, loan origination fee, service charge, or any other charge equal to 1 percent of the principal amount of a loan which is charged by the lender at or before the time the loan is made as additional compensation for the loan." CL § 12-101(h). The circumstances under which a lender may charge points are set forth in CL § 12-108.

In the past, it has been the practice of mortgage lenders to require the borrower to pay, at the time of the loan closing, the amount of interest on the loan that will accrue between the closing date and the beginning of the first full month. This practice made it possible to recite even monthly installments of principal and interest in the deed of trust note used in connection with CDA loans. However, the enactment of CL § 12-103(b)(1)(vi) effectively prohibited lenders from requiring that interest for the partial month, or "odd days," be paid in advance. Accordingly, CDA has furnished to its lenders mandatory loan closing documents that do not provide for advance payment of a partial month's interest.

II

DIDMCA Preemption Provisions

DIDMCA § 501(a)(1) expressly preempts State usury laws applicable to first mortgages on residential property: "The provisions of the constitution o[r] the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance" that is secured by a first lien on residential real property. n5 However, regulations adopted by the federal Home Loan Bank Board make it clear that the DIDMCA does not preempt "limitation[s] in state laws on prepayment charges, attorneys' fees, late charges or other provisions designed to protect borrowers." 12 C.F.R. § 590.3(c). n6

n5 DIDMCA § 501(a)(1) applies to all "federally related mortgage loans," as described in 12 U.S.C. § 1735f-5 and as that description is expanded by DIDMCA § 501(a)(1)(C). Thus, the preemption applies to any loan that is:

(1) Secured by residential real property, stock in a residential cooperative housing corporation, or a first lien on a manufactured home; and

(2) Made by a lender insured or regulated by an agency of the federal government, approved by the Secretary of Housing and Urban Development for participation in a mortgage insurance program under the Nation Housing Act, or who is an individual financing the sale or exchange of the individual financing the sale or exchange of the individual's principal residence; or

(3) Made, insured, guaranteed, supplemented, or assisted in any way by an officer or agency of the federal government or under or in connection with a housing, urban development, or related program administered by a federal officer or agency; or

(4) Eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation or is from a financial institution from which it could be purchased by the Federal Home Loan Mortgage Corporation; or

(5) Made by a creditor who makes or invests in residential loans including loans or credit sales secured by first liens on manufactured homes, aggregating more than $1,000,000 per year; or

(6) Made by any creditor who sells manufactured homes financed by loans or credit sales, if the creditor has an arrangement to sell or does sell the loans or credit sales to another lender, institution, or creditor that does make or invest in residential real estate loans or loans or credit sales secured by first liens on manufactured homes aggregating more than $1,000,000 per year.

n6 This regulation codifies a statement in the legislative history that DIDMCA § 501(a)(1) was not intended to preempt "limitations on prepayment charges, attorney fees, late charges, or similar limitations designed to protect borrowers." S. Rep. No. 368, 96th Cong., 2nd Sess. 19, reprinted in 1980 U.S. Code Cong. & Admin. News 236, 255.

DIDMCA § 501(b)(2) authorizes states to override the federal preemption of their usury laws. n7 To do so, a state must adopt, between April 1, 1980 and April 1, 1983, a provision "which states explicitly and by its terms that such State does not want the provisions of subsection (a)(1) to apply with respect to loans, mortgages, credit sales, and advances made in such state." To be effective, any state override provision must be very specific:

Under this requirement the state law, constitutional provision, or other override proposal must specifically refer to this Act and indicate that the state intends to override the federal preemption this Act provides. Since each of the [DIDMCA's] federal preemptions provides for a separate right of state override, the state's override proposal would be required to refer to the specific preemption, such as that on mortgage loans . . . .

S.Rep. No. 368, 96th Cong., 2d Sess. 79, reprinted in 1980 U.S. Code Cong. & Admin News 236, 309.

n7 DIDMCA § 501(b)(4) permits states, at any time after March 31, 1980, to "adopt a provision of law placing limitations on discount points" charged in connection with residential mortgages. CL § 12-103(b)(1)(vi) clearly is not such a provision - points are expressly exempted from its operation.

CL § 12-103 was amended during the period between April 1, 1980 and April 1, 1983 by Chapter 752 of the Laws of Maryland 1982, but that enactment made no reference to federal law. n8 The prohibition against requiring payment of interest in advance was enacted by Chapter 628 of the Laws of Maryland 1986, long after the period set by DIDMCA § 501(b)(2); Chapter 628 also made no reference to the federal law.

n8 Chapter 2 of the Laws of Maryland 1981 also amended CL § 12-103, but that enactment made only technical corrections and was not intended to affect any substantive law.

In light of the specificity required for a State law override of the federal preemption, it is clear that Maryland has not overriden the federal preemption. Therefore, if CL § 12-103 (b)(1)(vi)'s prohibition against requiring the payment of interest in advance is a limit on the "rate or amount of interest, discount points, finance charges or other charges," it has been preempted by federal law. If, however, it is a provision "designed to protect borrower," like a limitation on prepayment charges, attorneys' fees, or late charges, it is exempt from preemption under 12 C.F.R. § 590.3(c).

III

Exemption from Federal Preemption

The provisions of CL § 12-103(b)(1) are in part designed to protect borrowers. For example, CL § 12-103(b)(1(i) requires a written agreement signed by the borrower setting forth the rate of interest charged, and CL § 12-103(b)(1)(iii) prohibits the imposition of prepayment penalties. Those provisions clearly are not preempted. 12 C.F.R. § 590.3(c). The prohibition against requiring payment of interest in advance was enacted as part of an effort to reduce closing costs for home buyers. However, we think that it is not the kind of provision to which federal preemption is inapplicable.

Prepayment charges, attorneys' fees, and late charges are not interest on the loan itself, but ancillary fees or penalties. That is, they do not reflect the actual cost of credit, but incidental expenses that a lender may incur in handling a loan - for example, in processing a payment made early or late. Hence, restrictions on the amount of those fees or penalties protect borrowers from being required to pay undue amounts in penalties or incidental expenses not related to the cost of credit.

The "odd days" interest addressed by CL § 12-103(b)(1)(vi), in contrast, is not such an ancillary expense. Rather, it is normal interest on the loan for the period between the loan closing date and the beginning of the first full month. Moreover, the prohibition against requiring payment of that interest in advance was not enacted to protect consumers from an unduly large fee or penalty, but to postpone the date on which they may be required to pay interest actually accruing on the loan itself. Therefore, we believe that CL § 12-103(b)(1)(vi) is not exempt from federal preemption under 12 C.F.R. § 590.3(c). n9

n9 For much the same reason, we think that "odd days" interest is not the equivalent of discount points, which may be limited under DIDMCA § 501(b)(4). A point is a fee or charge imposed in addition to the interest payable over the term of the loan and designed, in general, to recoup the lender's administrative or operating costs in negotiating a loan. See CL § 12-101(h); B.F. Saul Co. v. West End Park North, Inc., 250 Md. 707, 714, 246 A.2d 591 (1968). That "odd days" interest is not an additional charge, but only the application of the normal interest on the loan to a portion of the loan's term, is illustrated by the difference in practical effects of points and "odd days" interest. The amount of money that a lender receives as a point does not vary with the length of time between the closing date and the beginning of the first full month. The amount of money received as "odd days" interest does, of course, vary according to the length of time to which it applies, just as the total amount received as interest on the entire loan varies with the term of the loan.

IV

Preemption of CL § 12-103(b)(1)(vi)

A. Effect of CL § 12-103(b)(1)(vi)

CL § 12-103(b)(1)(vi) is not a direct restriction on the rate of interest that may be charged for a loan secured by a residential mortgage: The amount of "odd days" interest due is calculated at the rate that applies to the full term of the loan, which the lender is authorized to set at the market rate. The State law provision regulates only the time at which interest on the "odd days" portion of the loan may be collected.

However, the time when a payment is received necessarily affects its value to the lender because the ability to make use of or receive interest on money during a given time is itself of value to the recipient. Thus, by delaying the date when interest for "odd days" may be received, CL § 12-103(b)(1)(vi) decreases the effective value of that interest to the lender. In our view, CL § 12-103(b)(1)(iv) is therefore an effective limit on "the amount of interest, discount points, finance charges, or other charges which may be . . . received" by the lender.

B. Legislative Intent

Further, the legislative history of the federal preemption provision clearly states Congress's intent to preempt limitations on all charges that are included in the "annua percentage rate." S.Rep. 368, 96th Cong., 2nd Sess. 19, reprinted in 1980 U.S. Code Cong. & Admin. News 236, 255. The annual percentage rate, which the Truth in Lending Act requires be disclosed in connection with any extension of consumer credit, reflects the amount of the finance charge for the credit. 15 U.S.C. § 1606. n10 The finance charge is "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditors as an incident to the extension of credit." 15 U.S.C. § 1605(a). Clearly, the interest charged for the period between the closing of the loan and the beginning of the first full month is a part of the finance charge for the loan. Accordingly, we believe that, because CL § 12-103(b)(1)(vi) effectively reduces the value of "odd days" interest, it is within the intended scope of DIDMCA § 501(a)(1).

n10 The regulations adopted under the Truth and Lending Act define "annual percentage rate" as "a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made." 12 C.F.R. § 226.22(a)(1). The term "finance charge" means "the cost of consumer credit as a dollar amount." 12 C.F.R. § 226.4(a).

C. Purpose of DIDMCA § 501

To be sure, the decrease in effective value of the "odd days" interest in any particular case may be small. But the overall effect of the provision may be significant for a lender that issues large numbers of mortgage loans or for which mortgage lending is a major part of the lender's business. Therefore, we believe that construing DIDMCA § 501(a)(1) as applicable to the prohibition against requiring the payment of interest in advance comports with the purpose for which the federal preemption was enacted.

Mortgage lenders typically carry large portfolios of outstanding mortgages issued over a number of years. When market rates of interest are volatile, lenders may face a large negative difference between the market interest rates and the average rates of mortgages in their portfolios. To avoid loss in a volatile interest market, lenders must have the ability to issue new loans at market rates. Patently, state usury laws that restrict lenders to below-market rates restrict their ability to participate successfully in the mortgage lending market. Lindenberg v. First Federal Savings & Loan Association, 528 F.Supp. 440, 446-47 (N.D. Ga. 1981).

The DIDMCA was enacted during such a period of rapidly escalating market interest rates. The Senate Banking, Housing, and Urban Affairs Committee's Report on the legislation explained the adverse effects at the national level that State usury laws can have under those circumstances:

(W)here state usury laws require mortgage rates below market levels of interest, mortgage funds in those states will not be readily available and those funds will flow to other states where market yields are available. This artificial disruption of funds availability not only is harmful to potential home buyers in states with such usury laws, it also frustrates national housing policies and programs.

A stable home financing system was the principal reason for the establishment by the federal government of the FHA and VA programs, the federal chartering of savings and loan associations, and the national secondary market mechanisms.

. . .

The Committee believes that this limited modification in state usury laws will enhance the stability and viability of our nation's financial system and is needed to facilitate a national housing policy and the functioning of a national secondary market in mortgage lending.

S.Rep. No. 368, 96th Cong., 2nd Sess. 19, reprinted in 1980 U.S. Code Cong. & Admin. News 236, 254-55.

DIDMCA § 501 was specifically enacted "to ease the severity of the mortgage credit crunches of recent years" by removing artificial disruptions in the national mortgage lending market caused by restrictive state laws. Id., reprinted in 1980 U.S. Code Cong. & Admin. News 254. See also Bank of New York v. Hoyt, 617 F.Supp. 1304, 1309 (D.R.I 1985). DIDMCA was intended to apply broadly, to facilitate the free flow of capital for homebuying into all states. Doyle v. Southern Guaranty Corp., 795 F.2d 907, 911 (11th Cir. 1986). It was expected that the law would "assist both borrowers and lenders by freeing up additional credit for housing." Quiller v. Barclays American/Credit, Inc., 764 F.2d 1400, 1403 (11th Cir. 1985) (Hill, J., dissenting).

Because CL § 12-103(b)(1)(iv) reduces the value of "odd days" interest, it has the potential to render the Maryland mortgage market less attractive to lenders. To be sure, its effect is unlikely to be as severe as that of a state law setting mortgage rates at a level below the market rate for the entire period of the loan. Nonetheless, we think that it may create the kind of artificial disruption in the market that DIDMCA was intended to prevent.

V

Conclusion

In summary, it is our opinion that CL § 12-103(b)(1)(vi) is a limitation on the amount of interest that a lender may receive for a loan secured by a first mortgage on residential property. As such, it is preempted by DIDMCA § 501(a)(1). Accordingly, lenders who make loans secured by first mortgages on residential property may not be prohibited from collecting interest in advance at the time of loan closing.

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EXHIBIT C

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Citation # 4
1994 ots lexis 37

Office of Thrift Supervision

1994 OTS LEXIS 37

September 29, 1994

Dear Text Omitted

This responds to your inquiry submitted on behalf of Text Omitted (the "Association"), raising several questions about § 4(g) of the Home Owners' Loan Act ("HOLA"), which is commonly referred to as the savings association Most Favored Lender Provision. In general, HOLA § 4(g) authorizes savings associations to charge interest on loans at the maximum rate authorized for any class of lender under the laws of the state where the association is located, thereby preempting any state law that might attempt to limit savings associations to lower interest rates. Under HOLA § 4(g), savings associations are permitted to use the most favored lender rate of their location state for any loan made or "booked" in that state, even if the borrower resides in another state. n1 This is commonly referred to as "exporting."

n1 E.g., OTS Op. Chief Counsel, Dec. 24, 1992.

You have asked two questions. First, you ask whether, under HOLA § 4(g), a savings association may charge (and export) the same credit card fees as are authorized by state law for the most favored lender in whose shoes the association seeks to stand. n2 This question was addressed in an opinion issued by the former Federal Home Loan Bank Board ("FHLBB"). FHLBB Op. by Quillian, June 27, 1986 (copy attached). The FHLBB held that loan fees are covered by the savings association Most Favored Lender Provision and, therefore, may be exported in the same manner as interest rates.

n2 The fees you have asked about are annual fees, late fees, return check fees, cash advance fees, and overlimit fees.

Opinions of the former FHLBB constitute valid and binding precedent for savings associations unless or until modified or revoked by the Office of Thrift Supervision. Therefore, the Association may continue to rely on the June 27, 1986 FHLBB opinion. n3 We note that the conclusion reached in the FHLBB opinion was recently confirmed in Ament v. PNC National Bank et al., No. 92-244 (W.D. Pa., April 8, 1994). To our knowledge, this is the only judicial decision to ever address exportation of loan fees by savings associations. The conclusion reached in the FHLBB opinion is also consistent with substantial case law developed in connection with the virtually identical national bank and state bank Most Favored Lender Provisions. n4 n3 At the time the FHLBB opinion was issued, the savings association Most Favored Lender Provision was codified as § 414 of the National Housing Act. 12 U.S.C. § 1730((1982). The Most Favored Lender Provision was subsequently moved to HOLA § 4(g) by § 408 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, without substantive change. See e.g., S. Rep. No. 19, 101st Cong., 1st Sess., 332 (1989). Thus, FHLBB interpretations of § 414 of the National Housing Act continue to apply to HOLA § 4(g).

n4 E.g., Greenwood Trust Company v. Commonwealth of Massachusetts, 971 F.2d 81 (1st Cir. 1992), cert. den., 113 S. Ct. 974 (1993); Fisher v. First National Bank of Omaha, 548 F.2d 255, 257-261 (8th Cir. 1977); and Northway Lanes v. Hackley Union Bank & Trust Co., 464 F.2d 855, 864 (6th Cir. 1972).

Your second question concerns what state consumer protection laws will apply when a savings association exports under the Most Favored Lender Provision. This question has also been addressed in a prior interpretive opinion. OTS Op. Chief Counsel, April 2, 1992 (copy attached). There we concluded that, when originating a loan under the Most Favored Lender Provision, a savings association is required to follow the state consumer protection laws that are applicable to the most favored lender in whose shoes the association seeks to stand, rather than the consumer protection laws of the state of the borrower's residence.

If you have further questions, please feel free to contact Evelyne Bonhomme, Counsel (Banking and Finance), at (202) 906-7052.

Very truly yours,

(signed)
Karen Solomon
Deputy Chief Counsel

cc: Regional Director
Regional Counsel
Central Region

June 27, 1986

This is in response to your letter dated April 17, 1986, requesting the opinion of the Office of General Counsel as to whether section 522 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), 12 U.S.C. § 1730g, and the Board's implementing regulation, 12 C.F.R. § 570.11, allow an insured institution to "export" (1) the interest rates of the state where it is located to borrowers in states that have over-ridden or "opted out" of section 522, and (2) the integral noninterest-rate features of its loan programs to borrowers in states that restrict or prohibit such features, whether or not such states have opted out of section 522. You note that the loans of the programs about which you inquire will be "booked" or "made" (that is, underwritten, approved, processed, and disbursed) in offices of the institution in the state in which it is located. For the reasons explained below, I have concluded that an insured institution is authorized to export both the interest rate and integral noninterest-rate features of its loan programs to borrowers in other states, regardless of whether such states restrict such features or have opted out of section 522.

Pursuant to section 522, an insured institution may charge an interest rate equal to the greater of one percentage point above the discount rate on ninety-day commercial paper in the institution's Federal Reserve district or "the rate allowed by the laws of the State" where it is located if either such rate is greater than that otherwise permitted to the institution. 12 U.S.C. § 1730g(a). In section 570.11(a), the Board interpreted "the rate allowed by the laws of the State" to be the amount which the most favored lender in the state may charge on a particular class of loans. To use the status of a most favored lender, the insured institution must make the same type of loan as the most favored lender and satisfy certain "substantive" state-law requirements pertaining to the type of loan being made. 12 C.F.R. § 570.11(b). Under section 525 of the DIDMCA, 12 U.S.C § 1730g note, a state may override the applicability of section 522 to loans made in that state. This Office has previously concluded, in an opinion letter dated December 11, 1984, that section 522 "empowers the main office or any branch office of an insured institution to use and export the most-favored-lender rates of the state where such office is located on any loan or other extension of credit booked at that office." That conclusion was based in part upon the fact that section 522 was enacted to provide insured institutions with competitive equality with commercial banks.

The first question you pose is whether an insured institution may export the interest rates of the state where it is located to borrowers in states that have opted out of section 522. As noted above, under section 525 a state may opt out of section 522 only with respect to loans "made" in such state. Thus, the fact that a state has opted out of section 522 should not affect the ability of an insured institution not located in that state to export most-favored-lender rates to that state, so long as the loans are made in the state where the institution is located rather than in the state that has opted out of section 522. The legal staff of the Federal Deposit Insurance Corporation ("FDIC"), in an opinion construing section 521 of the DIDMCA, 12 U.S.C. § 1831d (the comparable provision conferring "most favored lender" status on state-chartered, FDIC-insured banks), explicitly concluded that if the state where a bank is located has not opted out under section 525, the bank may charge its home-state rate to residents of any other state, even if the latter state has opted out of section 521. Letter from Peter M. Kravitz, FDIC Senior Attorney, to Peter D. Schellie (Oct. 20, 1983).

For these reasons, this Office concludes that an insured institution, pursuant to section 522, may offer loans to out-of-state customers at interest rates authorized in the state where the institution is located, even if the state where the borrower lives (or where the collateral lies or the loan proceeds are spent) has exercised its "opt out" authority under section 525, so long as the loan is made in the state where the institution is located.

The second question you pose is whether an insured institution may export the integral noninterest-rate features of its loan programs to borrowers in states that restrict or prohibit such features, whether or not such states have opted out of section 522. Both the Comptroller of the Currency ("OCC") and the Board require lenders using most-favored-lender status to comply with certain state-law provisions that relate to their loans.

Under 12 C.F.R. § 7.7310, the OCC requires national banks using most-favored-lender rates to comply only with state-law provisions that are "material to the determination of the interest rate" for a specified class of loans. The OCC has interpreted provisions to be "material" if they either set forth the characteristics of a category of loans or establish how the most-favored-lender numerical rate of interest is determined. Moreover, "material" state-law provisions may be exported, regardless of whether such provisions are permissive or restrictive. Letter from Roberta W. Boylan, Director, OCC Legal

Advisory Services Division (Nov. 18, 1985). See also Northway Lanes v. Hackley Union National Bank & Trust Co., 464 F.2d 855 (6th Cir. 1972) (holding that a national bank in Michigan could collect closing costs in addition to interest because Michigan law permitted the most favored lender to do so). In section 570.11(b), the Board ruled that to use the status of a most favored lender an insured institution must comply with "substantive" state-law requirements -- including those related to loan term amount, use of proceeds, identity of borrower, and mandatory consumer protections -- that pertain to the type of loan being made.

In view of the ability of a national bank to export the permissive features of a loan program that are material to the determination of the most-favored-lender rate, insured institutions should be permitted to do the same because such features are "substantive." Integral noninterest-rate features such as late charges, annual fees, change-in-terms authorization, and variable interest rates are substantive because they directly affect the determination of the maximum interest rate and yield allowed by a state. Therefore, this Office is of the opinion that when an insured institution exports its home-state interest rate it necessarily exports such substantive features of the loan program, regardless of whether they are restrictive or permissive. Pursuant to our answer to your first question, it follows that this is so regardless of whether the state to which the most-favored-lender interest rate and integral noninterest-rate features of a loan program are exported has opted out of section 522.

Sincerely,

(signed)
Harry W. Quillian
Acting General Counsel

April 2, 1992

Text Omitted

RE: Federal Preemption of Illinois State Law Regulating Credit Cards and Most Favored Lender Status, Sections 5(a) and 4(g) of the Home Owners' Loan Act

Dear Mr. Text Omitted

This responds to your letter inquiring whether Text Omitted (the "Association"), must comply with the Illinois Issuance and Use of Credit Card Act (Ill. Rev. Stat. 1989, ch. 17, par. 6001, et seq.), as amended ("Illinois Credit Card Act").

Based on our review of the Home Owners' Loan Act ("HOLA"), implementing regulations, and relevant federal case law, we conclude that the Association is not required to comply with the Illinois Credit Card Act. State authority over the lending operations of federally chartered associations is preempted by HOLA. Thus federal associations are obligated to comply with state lending laws only if, and to the extent, those laws are expressly incorporated into federal law. Although HOLA § 4(g) and the OTS' implementing regulations do require savings associations that seek to take advantage of the Most Favored Lender Doctrine (described below) to comply with certain laws of the state in which they are deemed to be "located" when making a loan or an extension of credit based upon the facts presented, the Association is not "located" in Illinois within the meaning of HOLA § 4(g) and, thus, not obligated to comply with the Illinois Credit Card Act.

I. Background

The Association's home office is located in Maryland. However, the Association issues credit cards nationwide. Approximately 2.8 percent of the Association's credit cards are issued to customers who live in Illinois. The association has no branch offices or any other facilities in Illinois. The Association's only out-of-state branches are located in Virginia and Washington, D.C.

The Illinois Commissioner of Banks and Trust Companies (the "Commissioner") has advised the Association that because it issues credit cards to Illinois residents it must comply with the Illinois Credit Card Act. The Act provides, inter alia, that any institution that issues credit cards to residents of Illinois must: report its name, address, and credit card terms to the Commissioner; pay a filing fee based on the number of credit cards issued to Illinois residents; and include a statement in all credit card statements advising cardholders that they can obtain information about comparative credit card terms from the Commissioner.

You seek confirmation that the Association, a federal savings bank that maintains its home office in Maryland and has no branch offices in Illinois, is not required to comply with the Illinois Credit Card Act.

II. Discussion

On numerous prior occasions, the federal courts and the OTS' predecessor, the Federal Home Loan Bank Board ("FHLBB"), have been called upon to consider whether a particular state law that purports to regulate the lending activities of a federal savings association is preempted. In each instance, the conclusion has been the same: the HOLA and its implementing regulations preempt such laws. n1

n1 E.g., Fidelity Federal Savings and Loan Association v. de la Cuesta, 458 U.S. 141, 159-167 (1982); Conference of Federal Savings and Loan Associations v. Stein, 604 F.2d 1256 (9th Cir. 1979); Meyers v. Beverly Hills Federal Savings and Loan Association, 499 F.2d 1145 (9th Cir. 1974); Olsen v. Financial Federal Savings and Loan Association, 4[illegible]4 N.E.2d 406 (Ill. Ap. 1982); FHLBB Op. by Solomon, December 13, 1988; FHLBB Op. by Smith, June 29, 1988; FHLBB Op. by Luke, June 13, 1989; FHLBB Op. by Quillian, April 28, 1987; FHLBB Op. by Williams, March 11, 1986; and FHLBB Op. by Raiden, November 12, 1985.

The Illinois Credit Card Act is no exception. The Act purports to regulate the credit card activities of federal savings associations in direct contravention of: (i) HOLA § 5(a) and 12 C.F.R. § 545.2, which provide for exclusive federal regulation of the operations of federal savings associations; (ii) HOLA § 5(b)(4), which expressly authorizes federal savings associations to engage in credit card operations "subject to regulations of the Director" of OTS; and (iii) the federal regulations implementing HOLA § 5(b)(4), which are found at 12 C.F.R. § 545.41. The preamble to these regulations specifies that the credit card operations of federal associations are "subject only to the limitations in the [federal] regulations" and that state laws purporting to regulate credit card operations are expressly preempted. n2 Under relevant principles of federal preemption -- which are discussed in great detail in the above-cited opinions and, therefore, not repeated here -- the foregoing statutory and regulatory provisions are sufficient to preempt application of the Illinois Credit Card Act to federal savings associations.

n2 48 Fed. Reg. 32,032, 32,033 (1983) (emphasis added).

Thus, the Association could be subject to the Illinois Credit Card Act only if the Act were incorporated by reference into federal law. In this regard, you have asked us to confirm that the Illinois Credit Card Act is not applicable to the Association by virtue of the Most Favored Lender Doctrine.

That Doctrine is derived from HOLA § 4(g), which provides as follows:

(1) Notwithstanding any State law, a savings association may charge interest on any extension of credit at a rate of not more that 1 percent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district in which such savings association is located or at the rate allowed by the laws of the State in which such savings association is located, whichever is greater. n3

n3 12 U.S.C. § 1463(g) (emphasis added).

The underlined language in the foregoing statutory provision has been interpreted by the OTS to permit each federal savings association to elect to "charge interest at . . . the rate allowed to the most favored lender on the particular class of loans" under the laws of the state in which the association is located. n4 If an association elects to take advantage of the Most Favored Lender Doctrine, however, the OTS requires the association to comply with any "substantive" state laws that would be applicable to the state's most favored lender when making that same type of loan. n5

n4 12 C.F.R. § 571.22(a). The term "most favored lender" means that category of lender (e.g., individuals, state banks, small loan companies) that is permitted by state law to make the same type of loan that the savings association wishes to make at the most favorable (i.e., highest) interest rate. See e.g., 46 Fed. Reg. 13,987, 13,988 (Feb. 25, 1981).

n5 12 C.F.R. § 571.22(b) and (c).

You have asked us to confirm that, under the Most Favored Lender Doctrine, the Association may issue credit cards in Illinois at the maximum credit card rate permitted for the most favored lender in the state of Maryland, subject to compliance with any substantive requirements imposed by the state of Maryland, without regard to credit card restrictions imposed by the state of Illinois. Your understanding is correct.

In Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978), the Supreme Court considered a provision in the National Bank Act that is very similar to HOLA § 4(g) and determined that the national bank there in question was "located" only in Nebraska, the state listed in the bank's organizational certificate, notwithstanding the fact that the bank was issuing credit cards to residents of Minnesota. The Supreme Court held that the bank could "export" Nebraska's most favored lending rate when issuing credit cards to Minnesota residents. Although the Court placed great emphasis on the bank's organizational certificate in deciding where the bank was located, the Court expressly noted that the bank had no Minnesota branch offices and suggested, by citing to Seattle Trust & Savings Bank v. Bank of California, 492 F.2d 48 (9th Cir. 1979), that its conclusion that the bank was not located in Minnesota might have been different if branch offices of the bank had been located there.

In reliance upon Marquette, the former FHLBB issued several interpretative opinions in which it concluded that a savings association that has no out-of-state branches is "located" only in the state of its home office notwithstanding the fact that the association may make loans in other states. n6 This interpretation was confirmed in Gavey Properties/762 v. First Financial Savings & Loan Association, 845 F.2d 519 (5th Cir. 1988). The FHLBB also issued several opinions holding that, when an association has out-of-state branches, the association is located, for purposes of HOLA § 4(g), in the state in which its home office is located and also in any state in which it has a branch office. n7 Therefore, these opinions held, an association with out-of-state branches that "books" a loan from an out-of-state branch may, if it chooses, use the most favored lender rate of the state in which that branch is located, rather than the most favored lender rate of the association's home state, provided the loan is made in conformity with the substantive laws of the state in which the branch is located. n8

n6 See FHLBB Op. by Raiden, July 23, 1984; FHLBB Op. by Laird, March 31, 1981; and FHLBB Op. by Laird, February 25, 1981.

n7 See FHLBB Op. by Quillian, June 27, 1986; and FHLBB Op. by Raiden, December 11, 1984, which overruled FHLBB Op. by Raiden, July 23, 1984, to the extent inconsistent therewith.

n8 Historically, a loan or extension of credit has been deemed to be "booked" out of a branch office when that loan is "underwritten, approved, processed, and disbursed" from that office. FHLBB Op. by Quillian, June 27, 1986. There may also be other circumstances in which an association will be able to demonstrate to the satisfaction of the OTS that a credit transaction was "booked" out of a branch office. Cf. Marquette, supra. at 311-312 (listing various factors the Court there considered relevant to its determination of location).

Since the Association's home office is located in Maryland and its only branch offices are located in Maryland, Virginia, and Washington, D.C., we conclude, consistent with the foregoing precedent, that the Association is not located in Illinois and is not subject to the Illinois Credit Card Act. When issuing credit cards in Illinois (or elsewhere), the Association may use the most favored lender rate of the state of Maryland, provided the Association complies with the substantive credit card laws of the state of Maryland. If the credit card transactions are actually "booked" out of a branch in Virginia or Washington, D.C., the Association also has the option of using the most favored lender rate of Virginia or Washington, D.C., as the case may be, provided it complies with the substantive credit card laws of that jurisdiction.

In reaching the foregoing conclusions, we have relied on the factual representations contained in the materials you submitted to us. Our conclusions depend on the accuracy and completeness of those representations. Any material change in facts from those set forth in your submission could result in different conclusions.

If you have any questions about this response, please feel free to contact Lorraine E. Waller, Senior Attorney, at (202) 906-6458.

Very truly yours,

(signed)
Harris Weinstein
Chief Counsel

cc: Southeast Regional Director
Southeast Regional Counsel

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