SB 347

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 347 (Senators Middleton and Astle)
Finance Economic Matters

Credit Regulation - Credit Grantor Provisions - Fees, Charges, and Penalties

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This emergency bill states that the additional fees and charges currently permitted by statute with respect to unsecured open- and closed-end credit plans may be imposed, charged, and collected at any time. The bill would thus allow State-chartered banks and independent mortgage lenders to continue the practice of "recapturing" loan closing costs, initially paid for by the lender, in the event that the borrower prepays the loan before a certain time.

Fiscal Summary

State Effect: The bill would not directly affect State finances or operations. If the Attorney General's Office receives fewer than 50 complaints per year stemming from the bill, the additional workload could be handled with existing resources.

Local Effect: The bill would not directly affect local finances or operations.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill creates exceptions to the penalty provisions that currently apply to credit grantors in violation of the laws governing open- and closed-end credit plans. These exceptions apply to contracts entered into prior to when the bill takes effect but do *not* apply to a case in which a final judgment has been rendered and for which all judicial appeals have been exhausted. Under the bill, credit grantors committing such violations are *not* restricted to collecting only the principal amount extended if the credit grantor

used a form or procedure that has been approved by the Commissioner of Financial Regulation, or performed or omitted an act in conformity with or in reliance on • a written opinion of the Attorney General of Maryland; • a regulation adopted by the commissioner; • a written opinion by the commissioner or deputy commissioner; or • an interpretation by the commissioner in a written notice or examination report. These exceptions do not apply to an act or omission that occurs after • the opinion, regulation, or interpretation relied on is amended, repealed, or determined to be invalid for any reason by any judicial or other authority; or • approval for a form or procedure is amended, rescinded, or determined to be invalid for any reason by any judicial or other authority. The provisions of the bill relating to these exceptions may not be construed to • limit the imposition of any civil or criminal penalty for a knowing or willful violation of law; or • limit the power of the commissioner or the courts to order a refund to a borrower of monies collected in violation of the law.

Current Law: Credit grantors of open- and closed-ended credit plans may not impose fees or charges on a consumer borrower in addition to the interest or finance charges permitted by statute, with some specific exceptions. For example, charges for actual and verifiable fees incurred and not retained by the credit grantor are permitted for • attorney's fees for services rendered in connection with the preparation, closing, or disbursement of the loan; • any expense, tax, or charge paid to a governmental agency; • examination of title, appraisal, or other costs necessary or appropriate to the security of the loan; and • premiums for any insurance coverage permitted by applicable law. Prepayment charges and penalties are currently prohibited by State statutory credit regulations for most loans, including loans secured by a borrower's primary residence. State law does not specify whether loan closing cost recapture fees constitute a prepayment charge or penalty.

Background: The bill represents a two-pronged response by opponents of a recent decision of the Maryland Court of Appeals. On December 13, 2007, the court concluded in *Andrew Bednar v. Provident Bank of Maryland* that the practice of closing cost "recapture" violates the Maryland Credit Grantor law. Under a closing cost recapture plan, a lender pays the borrower's loan closing costs and agrees to defer collection of these costs from the borrower as long as the borrower keeps the loan open for a period of time. If the borrower keeps the loan open for the specified time, the lender forgives the closing costs, but if the borrower prepays and closes the loan, then the borrower is required to pay these costs to the lender. Closing cost recapture programs are a standard practice of lenders across the nation that offer an initial incentive to the borrower in exchange for an increased assurance that the borrower will not repay the loan before a certain time, as would occur if the borrower refinanced with another lender.

In *Bednar*, the Court of Appeals examined current State statute with respect to a situation in which a borrower who prepaid his loan was then charged for closing costs that had been initially paid by the lender. The court concluded that this charge was a prepayment charge that violated the Credit Grantor law, stating:

> It is undisputed that whether Bednar would be required to pay the $681 charge was entirely dependent upon whether he prepaid the Provident loan within three years. If Bednar prepaid the loan within three years, he was required to pay the charge. If he did not prepay the loan within three years, he was not required to pay the charge. Regardless of what else the $681 charge may have been, or how the amount was calculated, it was plainly a "prepayment charge." Section 12-1009(e) of the Commercial Law Article unambiguously and flatly mandates that, "[i]n connection with any prepayment of any loan by a consumer borrower, the credit grantor may not impose any prepayment charge." "Any" prepayment and "any" prepayment charge does not mean only "some" prepayments or "some" prepayment charges.

The court further noted that other jurisdictions reviewing these matters have similarly held that when a charge is conditioned on prepayment, it constitutes a prepayment charge. In addition, the court held current State statutory law did not permit Provident to impose the "recapture" charge based on the closing costs waiver certificate signed by Bednar, in which he agreed to the recapture program. The court based this holding on Section 12-1023(b)(3) of the Commercial Law Article, which states that, "[e]xcept as expressly allowed by law, an agreement, note, or other evidence of a loan may not contain a provision by which the borrower waives any right accruing to the borrower under this subtitle." The court also noted that the same statute deems any such clause in agreement as unenforceable.

In its conclusion, the court rejected Provident's reliance on prior opinion letters from two previous commissioners of Financial Regulation that had interpreted loan closing cost recapture programs as permissible and not in violation of statutory bans on prepayment penalties. The court concluded:

> Provident also cannot properly circumvent § 12-1009(e) by calling the imposition of the charges a "recapturing" of permitted costs. A person or entity is not permitted to evade statutory prohibitions by using a different label for the prohibited conduct…. Our holding in this case does not impose a time limit on collecting permissible charges. Rather, we simply hold that the collection of such charges may not be dependent upon prepayment.

Due to the *Bednar* decision, Maryland-chartered banks, credit unions, and independent mortgage lenders are no longer permitted to employ loan closing cost recapture programs in order to initially waive these costs for borrowers. Due to federal preemption, however, financial institutions and affiliated mortgage lenders that are federally chartered or chartered in another state will continue to be able to offer closing cost recapture to borrowers when they do business in Maryland. This places Maryland-chartered lenders at a significant competitive disadvantage, because they are forced to charge closing costs upfront while their national and out-of-state counterparts are not. The bill seeks to address this situation by • allowing lenders to rely on the opinion of the commissioner in any claims that could currently be brought under the Credit Grantor law in which a final nonappellate judgment has not been entered; and • allow lenders to impose, charge, and collect closing costs at any time, including prepayment, for future loans.

Small Business Effect: To the extent that there are State-chartered lenders that can be classified as small businesses, the bill will allow such lenders to avoid a meaningful competitive disadvantage with national and out-of-state counterparts.

Additional Information

Prior Introductions: None.

Cross File: HB 852 (Delegate Davis, *et al.*) – Economic Matters.

Information Source(s): Department of Labor, Licensing, and Regulation; Office of the Attorney General (Consumer Protection Division); Department of Legislative Services

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