P-97-7

Office of Thrift Supervision
Department of the Treasury
Chief Counsel
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

August 25, 1997

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Re: Preemption of State Law Limiting Discount Points

Dear [ ]:

This responds to your inquiry on behalf of [ ] and its [ ]-licensed mortgage banking subsidiaries, [ ] and [ ] (collectively "[LENDER]"). You have asked the Office of Thrift Supervision ("OTS") whether § 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA")[1] preempts an Ohio law that limits the amount of discount points a lender may receive in connection with making a residential mortgage loan. You have also asked whether certain amendments adopted by the Ohio legislature in 1988 constituted an effective opt out of DIDMCA's preemption provisions with respect to discount points.

In brief, we conclude that § 501 of DIDMCA preempts the Ohio law with respect to federally related residential mortgage loans secured by a first lien on residential real property made after March 31, 1980. We also conclude that technical amendments adopted by the Ohio legislature in 1988 did not constitute an opt out of DIDMCA's preemption provisions with respect to discount points.

[1] 12 U.S.C.A. § 1735f-7a (West 1989), Pub. L. No. 96-221, 94 Stat. 161 (1980). The OTS, as successor to the Federal Home Loan Bank Board ("FHLBB"), is statutorily authorized to interpret and implement § 1735f-7a for all lenders, not just savings associations. See 12 U.S.C.§ 1735f-7a(f) (West 1989). The FHLBB's functions were transferred to the OTS pursuant to the Financial Institutions 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.A. § 1462a (West 1997).

I. Background

You represent that [LENDER] makes federally related mortgage loans as defined in § 501 of DIDMCA,[2] and that such loans are secured by first liens on residential real property. You also represent that Ohio Rev. Code § 1343.011(B), enacted in 1975, generally prohibits residential mortgage lenders from receiving discount points in excess of two percent of the original principal amount of a residential mortgage loan.[3] Amendments to Ohio Rev. Code § 1343.011 were adopted in 1988.

II. Discussion

A. DIDMCA Preemption

Section 501 of DIDMCA and OTS's implementing regulations[4] explicitly preempt state laws that limit the rate or amount of discount points that can be charged with respect to federally related mortgage loans. Section 501(a) of DIDMCA provides, in pertinent part:

> (1) The provisions of the constitution or 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 which is—
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> (A) secured by a first lien on residential real property, . . .;

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[2] DIDMCA § 501 references § 527 of the National Housing Act, 12 U.S.C.A. § 1735f-5(b)) (West 1989), which defines "federally related mortgage loan" to include any loan that is secured by residential real property and is made by any "creditor," as defined in the Truth in Lending Act ("TILA"), 15 U.S.C.A. 1602(f), who makes or invests in residential real estate loans aggregating more than $1 million per year. 12 U.S.C. § 1735f-5(b)(1) and (2)(D). You indicate that each of the [ ]-licensed mortgage banking subsidiaries is a "creditor" that makes or invests in residential real estate aggregating more than $1 million per year.

You also represent that one of the [ ]-licensed mortgage banking subsidiaries and two other subsidiaries of [ ] have been named in a class action ([ ]) in which the interpretation of DIDMCA is at issue, and in which plaintiffs allege that (1) Ohio Rev. Code § 1343.011(B) prohibits lenders in Ohio from charging discount points in excess of 2% of the original principal amount of first mortgage loans and (2) the 1988 amendments to Ohio Rev. Code § 1343.011 override DIDMCA's preemption.

[3] The statute contains an exception for residential mortgage loans described in another statutory provision, Ohio Rev. Code § 1343.01(B)(3), that permits parties to agree to pay a rate of interest in excess of that otherwise permissible where certain insurance, guarantees, approvals, or commitments are present.

[4] 12 C.F.R. Part 590 (1997). Part 590 was originally promulgated by the FHLBB. FIRREA provided that all regulations of the FHLBB would remain in effect until they were "modified, terminated, set aside, or superseded in accordance with applicable law by the Director of the [OTS]." Pub. L. No. 101-73, 401, 103 Stat. § 183, 356-357 (1989). The OTS reissued Part 590 on November 30, 1989. See 54 Fed. Reg. 49,715 (1989).

(B) made after March 31, 1980; and
(C) described in section 527(b) of the National Housing Act (12 U.S.C. 1735f-5(b)), ...[5]

. .

The language of OTS's implementing usury preemption regulation, 12 C.F.R. § 590.3, parallels the statutory language of § 501(a).[6]

The OTS's predecessor agency, the Federal Home Loan Bank Board ("FHLBB"), opined on several occasions that § 501 of DIDMCA and OTS's implementing regulations preempt state laws limiting the rate or amount of discount points that may be charged on federally related mortgage loans.[7] In one opinion, the FHLBB commented that:

> The decision to preempt state discount point restrictions reflects a Congressional determination that mortgage lenders will be more inclined to enter the housing market if they are able to take some interest upfront. In interpreting this aspect of the statute, we must evaluate state laws as to whether their net effect is to limit the amount of discount points chargeable. A state law need not impose an absolute limit on discount points to have this effect.[8]

Courts have similarly recognized that state laws limiting discount points are preempted by § 501 for federally related mortgage loans.[9]

It is therefore well established that § 501 of DIDMCA and its implementing regulations preclude a state from limiting the rate or amount of discount points that may

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[5] 12 U.S.C.A. § 1735f-7a(a)(1) (West 1989).

[6] See 12 C.F.R. § 590.3(a) (1997).

[7] See e.g., FHLBB Op. by Gen. Counsel (May 8, 1987) (Congress intended to preempt all provisions of state law limiting interest and other charges, such as discount charges, that are includable in the annual percentage rate); FHLBB Op. by Acting Gen. Counsel (February 4, 1986) (state law limiting interest charges includable in annual percentage rate is preempted); FHLBB Op. by Gen. Counsel (July 24, 1981) (state law prohibiting lenders from charging or receiving discount points from sellers of real estate as part of loan agreement is preempted); FHLBB Op. by Gen. Counsel (July 8, 1980) (state law limiting fees in assumption transactions could not be used to bar parties from contracting for discount points).

[8] FHLBB Op. by Assoc. Gen. Counsel (November 19, 1981).

[9] See Currie v. Diamond Mortgage Corp. of Illinois, 859 F.2d 1538, 1542 (7th Cir. 1981). See also Currie v. Diamond Mortgage Corp., 83 B.R. 536, 538 (N.D. Ill. 1987), aff'd, 859 F.2d 1538 ("The plain language of § 501 preempts state limitations on points for federally-related, residential mortgages.").

be charged with respect to federally related mortgage loans. Section § 1343.011(B) of the Ohio Rev. Code prohibits residential mortgage lenders from receiving from sellers or buyers of real estate discount points in excess of two percent of the principal amount of a residential mortgage loan and thus purports to limit discount points that may be charged on a federally related loan. Accordingly, DIDMCA § 501 preempts the Ohio statute for federally related mortgage loans unless, as discussed below, Ohio opted out of DIDMCA's preemption.

B. 1988 Amendments to Ohio Rev. Code § 1343.011

You have also asked us to concur in your view that amendments to Ohio Rev. Code § 1343.011 adopted by the Ohio Legislature in 1988 "did not override DIDMCA." In other words, did the 1988 amendments constitute an effective opt out of DIDMCA's preemption?

Although § 501(a) of DIDMCA preempts state limits on the rate or amount of interest, discount points, finance charges or other charges on certain loans, mortgages, credit sales, or advances, § 501 also provides two mechanisms for states to "opt out" of its preemption. First, § 501(b)(2) of DIDMCA provides that its preemption would not apply to loans made in a state that, during a specified period, adopted a law or certified that voters had voted in favor of a provision that stated "explicitly and by its terms that such State does not want the provisions of subsection (a)(1) of [§ 501] to apply with respect to loans, mortgages, credit sales, and advances made in such State."[10] You represent that Ohio did not opt out pursuant to this provision.

Second, § 501(b)(4) of DIDMCA provides that after March 31, 1980, any state may "adopt a provision of law placing limitations on discount points or such other charges on any loan, mortgage, credit sale, or advance described in subsection (a)(1) of [§ 501]."[11] Section 501(b)(4) does not specify the precise procedure by which a provision of law must be adopted in order to fall within the ambit of § 501(b)(4). The FHLBB observed, however, that the legislative history of § 501(b)(4) reveals that the provision was intended to permit states to place new restrictions on discount points.[12]

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[10] 12 U.S.C.A. § 1735f-7a(b)(2) (West 1989). The period during which states could opt out of DIDMCA's preemption was "on or after April 1, 1980, and before April 1, 1983." You indicate that Ohio did not take the required action within the specified period; therefore, § 501(b)(2) is not applicable.

[11] 12 U.S.C.A. § 1735f-7a(b)(4) (West 1989). See also, 12 C.F.R. § 590.3(b)(3)(1997).

[12] FHLBB Op. by General Counsel (June 18, 1981) at 2. This opt out provision was proposed by Senator Proxmire, who indicated that "States should have the flexibilty to enact new laws placing limitations on discount points or such other charges, without any time limitation." 125 Cong. Rec. S15688 (daily ed. Nov. 1, 1979) (statement of Sen. Proxmire).

Thus, it appears that in order to satisfy § 501(b)(4), the 1988 Ohio amendments must have been equivalent to enactment of a new substantive law limiting discount points.

Ohio Substitute House Bill No. 708 ("Sub. H.B. 708"),[13] passed by the Ohio Legislature on March 10, 1988, amended, inter alia, Ohio Rev. Code § 1343.011 by making the following changes: (1) removing a comma from subsection (A); (2) changing the phrase "shall include" to "includes" in subsection (A)(2); (3) deleting the term "building and loan association" from the definition of "residential mortgage lender" in subsection (A)(3); and (4) replacing "the effective date of this section" with the date "November 4, 1975" in subsection (C). No changes were made to subsection (B) of § 1343.011, the provision limiting the number of discount points residential mortgage lenders may receive when making residential mortgage loans. The amendments to § 1343.011 became effective on April 19, 1988.

The question thus presented is whether the action of a legislature in making technical, nonsubstantive amendments to a preexisting state statute constitutes "adopting a provision of law" within the meaning of § 501(b)(4) so as to be considered an effective opt out of DIDMCA's preemption of state limitations on discount points. In this regard, it is appropriate to examine the intent of the state legislature in enacting the amendments, as evidenced by the surrounding circumstances, including records of legislative proceedings, legislative committee reports, and the title of the amendment.[14]

You indicate there is some evidence of the Ohio legislature's intent in amending § 1343.011. Ohio Rev. Code § 1.30, titled "Intent of Code revision acts is nonsubstantive," provides (in subsection (A)):

> In enacting any legislation with the stated purpose of correcting nonsubstantive errors in the Revised Code, it is the intent of the general assembly not to make substantive changes in the law in effect on the date of such enactment. A section of the Revised Code affected by such an act shall be construed as a restatement and correction of, and substituted in a continuing way for, the corresponding statutory provision existing on its date of enactment."

Subsection (B) of §1.30 consists of a list of the "acts of the general assembly with the purpose described in division (A)" of § 1.30. In addition to amending § 1343.011,

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[13] H.B. 708 was renamed Sub. H.B. 708 during the Ohio legislative process.

[14] 1A Sutherland Statutory Construction § 22.29 (5th Ed 1993).

Sub. H.B. 708 also amended §1.30 of the Ohio Rev. Code to include a reference to "House Bill No. 708 of the 117th General Assembly."[15]

A description of Sub. H.B. 708 prepared by the Ohio Legislative Service Commission states, "This bill is the general nonsubstantive corrective bill. In conformity with R.C. 1.30, it states that it does not intend to make substantive changes in the law. This means that when the bill becomes law, the legal effect of each section affected by the bill will be the same as it was before the bill became law." The description further states, "The sections included for the purpose of nonsubstantive updates and corrections contain updates or corrections that would not appear to change the actual operation of the law." Finally, the Legislative Service Commission's "Section-by-Section Explanation" for § 1343.011 states that it substituted the actual effective date of the section in the place of a nonspecific reference to "the effective date" and contained "technical amendments." There is no indication that amendments were intended to address the issue of discount points or constitute an opt out of DIDMCA's § 501 preemption with respect to discount points.

Several FHLBB opinions addressed whether various state legislative actions may be viewed as satisfying the § 501(b)(4) opt out provision of DIDMCA with respect to the preemption of state laws limiting discount points. In one opinion, the FHLBB reviewed proposed state legislation regulating discount points in mortgage transactions that expressly stated its purpose was "to exempt, as provided in paragraph 2 of section 501 of Public Law 96-221, the Commonwealth from those provisions of section 501(a)(1) of said law which pre-empt any law limiting the amount of discount points or such other charges on any loan, mortgage, credit sale or advance secured by a first lien on residential property."[16] The FHLBB found the quoted language would be sufficient to establish new limits on the charging of discount points pursuant to § 501(b)(4).

Section 501(b)(4) does not require a legislature to explicitly state that its intention is to opt out of DIDMCA's preemption with respect to discount points.[17] However, a state's legislative action must have intended to restrict discount points and other such charges before the action can be found to displace the DIDMCA

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[15] Sub. H.B. 708, § 1.30(B)(15) (1988).

[16] FHLBB Op. General Counsel (July 3, 1980) quoting Massachusetts Bill 6358.

[17] See United Cos. Lending Corp. v. McGehee, 686 So. 2d. 1171, 1178 (S.Ct. Ala. 1996) citing Autrey v. United Companies Lending Corp., 972 F. Supp. 925, 928 (S.D. Ala. 1995). (1989 amendment to the Alabama Code, which enacted a new provision limiting discount points where none had existed before, but that did not specifically state that it wanted to override the DIDMCA preemption was an effective opt out of § 501(b)(4)).

preemption. In one FHLBB opinion[18] a state law forbade the assessment of discount points on first mortgage loans and prohibited pledged account mortgages. After DIDMCA's enactment, the state legislature amended its law to permit pledged account mortgages. Due to state procedural requirements, the state legislature could not amend the statute without reenacting the statutory prohibition against discount points at the same time. The FHLBB concluded that the technical reenactment of the state discount points restriction as part of a pro forma reenactment of the state usury laws was not a new legislative limitation under § 501 that displaced the federal preemption.

In another opinion, the FHLBB examined whether a legislature's amendment of a state law to limit assumption fees should be viewed as imposing discount point restrictions that displaced DIDMCA's preemption and concluded that it did not.[19] The FHLBB indicated that reimposition of the state discount point limitation would require a "reaffirmation" of a separate provision of law.

In the absence of any evidence that the Ohio legislature's action in 1988 was intended to limit discount points, we conclude that the 1988 amendments to Ohio Rev. Code § 1343.011 did not constitute an effective opt out of § 501 of DIDMCA's preemption of state law limitations on discount points or other similar charges.

In reaching the foregoing conclusions, we have relied upon the factual representations made in the materials you submitted. Our conclusions depend upon the accuracy and completeness of those representations. Any material difference in facts or circumstances from those described herein could result in different conclusions.

If you have any questions, feel free to contact Ellen Sazzman, Counsel (Banking and Finance), (202) 906-7133 or Susan Miles, Senior Attorney, (202) 906-6798.

Very truly yours,

/s/

Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel

[18] FHLBB Op. General Counsel (June 18, 1981).

[19] FHLBB Op. Senior Associate General Counsel (October 27, 1981).