Office of Thrift Supervision
Department of the Treasury

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March 1, 1994

MEMORANDUM FOR WILLIAM S. McCULLARS
SOUTHEAST REGION

FROM: Carolyn B. Lieberman
Acting Chief Counsel

SUBJECT: Collection of Late Charges on Home Equity Loans

This responds to your inquiry regarding 12 C.F.R. § 545.34(b) (1993). This regulation prohibits federal savings associations from assessing late charges on payments received on home loans that are secured by borrower-occupied property, provided the payment is received within 15 days after the due date.

You ask whether this provision applies to home equity loans made under the association's consumer lending authority. Although a lien on the borrower's home is taken for such loans, the institution relies on the borrower's creditworthiness as the primary security for such loans. A federal savings association within your region, [redacted], currently assesses a late charge on such loans when the payment is 10 days overdue.

For the reasons set forth below, we conclude that the 15-day late charge period applies to all home loans secured by borrower-occupied property, including loans that are made under an association's consumer loan authority.

Discussion

A federal savings association may originate, invest in, or otherwise deal in loans made on the security of residential or nonresidential real estate. 12 U.S.C. §§ 1464(c)(1)(B) and (c)(2)(B) and 12 C.F.R. § 545.32 (1993). A federal savings association may also make consumer loans, whether secured or unsecured, for personal, family or household purposes. 12 U.S.C. § 1464(c)(2)(D) and 12 C.F.R. § 545.50(b) (1993). However, consumer loans may not exceed a certain percentage of an association's assets. 12 U.S.C. § 1464(c)(2)(D).

If a loan or other investment is authorized under more than one provision of 12 U.S.C. § 1464(c), a federal savings association may designate the provision under which the loan or investment has been made. 12 C.F.R § 545.31(a) (1993). To classify a loan as a real estate loan, a federal savings

association must rely substantially upon the real estate as the primary security for the loan. Id. By contrast, consumer credit is defined as credit extended to a natural person for personal, family, or household purposes, including loans secured by liens on real estate, provided that the savings association relies substantially upon other factors such as the general credit standing of the borrower, guarantees, or security other than the real estate as the primary security for the loan. 12 C.F.R. § 561.12 (1993). The purpose of this election regarding classifications of loans or investments is to determine whether an association meets applicable percentage of assets investment limitations, not to determine what protections are afforded to a consumer who mortgages his or her home to secure credit.

Section 545.34(b) states that a federal savings association shall not assess a late charge as to any payment received by it within fifteen days after the due date of such payment. This section is applicable to "home loans secured by borrower-occupied property." This terminology is not further defined in the regulations. However, a home equity loan is a "home loan secured by borrower-occupied property" within the plain meaning of that phrase.[1]

This conclusion is consistent with various opinions of the former Federal Home Loan Bank Board ("FHLBB") addressing whether the requirements applicable to "home loans" or to "real estate loans" apply to consumer loans secured by real estate liens. Some of these opinions have concluded that at least certain requirements are applicable. For example, the FHLBB opined that 12 C.F.R. § 545.33(f)(1986) ("home loan" disclosure requirements) applied to all loans secured by homes including loans for consumer purposes that are granted primarily on the strength of the

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1. We have considered whether it could be argued that the presence of the word "home" in front of "loan secured by borrower-occupied property" may have been intended to limit application of § 545.34 to loans to fund the purchase of homes, i.e., purchase money mortgages. When § 545.34 is read in conjunction with the related regulations that immediately precede it, however, it becomes apparent that the term "home loan" is used as a shorthand reference for "any loan made on the security of homes." 12 C.F.R. § 545.33. In § 545.34, and in one provision in § 545.33 (see paragraph (c)), the phrase "secured by borrower-occupied property" qualifies the term "home loan." This signifies that those particular provisions apply only to loans made on the security of homes that are borrower-occupied. However, there is no indication that the phrases "made on the security of homes" and "secured by borrower-occupied property" mean anything more than that the association obtained a security interest in the home, without regard to the level of reliance the association placed on that security interest.

borrower's personal credit.[2] FHLBB Op. by Williams (July 29, 1986). The opinion reasoned that the purpose of the disclosure requirement was to provide a prospective borrower with complete and early information on the terms of the home loan, especially all sources of risk to the applicant's home. The opinion also observed that § 545.33 applied to "any" home loan, did not contain an exception for consumer loans, and referred expressly to one common type of consumer loan, a line-of-credit loan secured by a home.[3]

By contrast, other opinions have concluded that at least some requirements applicable to "home loans" or to "loans secured by real property" are not applicable to real estate-secured consumer loans. For example, until recently amended, 12 C.F.R. § 545.32(d)(2) required private mortgage insurance for "home loans" in excess of 90 percent of the appraised value of the secured property.[4] The FHLBB concluded that this requirement was not applicable to real estate-secured consumer loans where the real estate is not the primary security for the loan. FHLBB Op. by Smith (Sept. 19, 1988).[5] Similarly, the FHLBB opined that real estate-secured consumer loans were "loans not secured by real estate" rather than "loans secured by real estate" under the recordkeeping requirements at 12 C.F.R. § 563.170(c)(1). Thus, associations are not required to obtain inspection reports, documents affirming the quality and validity of the lender's lien, or records regarding the status of taxes, assessments, insurance premiums for such loans. FHLBB Ops. by Smith (Nov. 10, 1987 and Mar. 2, 1987). These opinions relied on such factors as: (1) the effect the requirements would have on a savings association's ability to compete with other lenders for consumer loans (i.e., increased costs or processing time); and (2) regulatory history indicating that the FHLBB did not intend to apply "loan closing" requirements to real estate-secured consumer loans and home-improvement loans based primarily on the creditworthiness of the borrower. See also 45 Fed. Reg 76104, at 76105 (Nov. 18,

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2. This requirement was amended and moved to 12 C.F.R. § 563.9-9 in 1988, redesignated as 12 C.F.R. § 563.99 in 1989, and recently deleted. (58 Fed. Reg. 4308, Jan. 14, 1993).

3. This opinion superseded an earlier opinion that reached the opposite conclusion. See FHLBB Op. by Deputy Chief Counsel (Aug. 1, 1985).

4. This provision was recently amended to give institutions more flexibility in deciding when to require private mortgage insurance. 57 Fed. Reg. 62890 (Dec. 31, 1992).

5. The OTS is currently re-examining the loan documentation requirements contained in 12 C.F.R. § 563.170(c)(1)-(7) in a proposed rulemaking implementing section 39 of the Federal Deposit Insurance Act. 58 Fed. Reg. 60802, at 60804 (Nov. 18, 1993).

1980); and 45 Fed. Reg. 76094, at 76095 (Nov. 18, 1980).

There is a clear line of demarcation between the two lines of precedent described above. The requirements that have been found to be applicable to real estate-secured consumer loans are consumer protection provisions, whereas the requirements that have been found inapplicable are safety and soundness provisions intended to protect lending institutions when they place significant reliance on real estate collateral to ensure repayment of loans. In situations where a lending institution is not relying on real estate as its primary source of repayment, ordinary real estate procedural safeguards are unnecessary to protect the institution. From the consumer's prospective, however, the pledge of a home as security for a loan presents the same basic risk -- potential loss of the home upon default on the loan -- regardless whether the association underwrites the loan as a consumer loan or home loan. Thus, it follows that the same consumer protections apply.

The purpose of the 15-day late charge period, like the loan disclosure requirement discussed above, is the protection of consumers. In this case, the provision protects borrowers by ensuring that they have adequate time to make an installment payment before late charges will be assessed.

Accordingly, we conclude that the 15-day late charge period applies to all loans secured by a home occupied by the borrower, even if the loan has been made under the association's consumer loan authority.[6] If you have any further questions about this matter, please feel free to call Karen Osterloh, Counsel (Banking and Finance), at (202) 906-6639.

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6. This opinion is consistent with a recent OTS opinion that concluded that § 545.34 does not apply to collection of late charges on automobile loans. OTS Op. Chief Counsel (Aug. 24, 1992).