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

Chief Counsel

April 30, 1996

[redacted]

Re: Effect of Parity Act on Wisconsin Prepayment Penalty Statute

Dear [redacted]

This responds to your inquiry to [redacted] ~~Region,~~ Office of Thrift Supervision ("OTS"), regarding whether the Alternative Mortgage Transaction Parity Act of 1982 (the "Parity Act"),[1] preempts the application of § 138.056(3)(a) of the Wisconsin Statutes ("Wisconsin Statute")[2] to loans made by Wisconsin-chartered savings and loan associations.[3] The Wisconsin Statute restricts prepayment penalties on variable-rate loans.

In brief, we conclude that variable-rate loans made by Wisconsin-chartered savings and loan associations in conformity with the Parity Act are not subject to the Wisconsin Statute.

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[1] Title VII of the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982), codified at 12 U.S.C.A. § 3801 et seq. (West 1989 & West Supp. 1996).

[2] Wis. Stat. § 138.056(3)(a).

[3] [redacted]

I. Background

The Wisconsin Statute provides:

> A variable rate loan involving a mobile home transaction or using an approved index may be prepaid at any time in whole or in part without penalty. Other variable rate loans may be prepaid in whole or in part without penalty within 30 days after notice of an increase in the interest rate and with the prepayment penalty under § 138.052(2)(a)2 and 3, if prepayment is made before or after the 30-day period.

Section 138.052(2)(a) pertains to prepayment penalties on fixed-rate "residential mortgage loans." Under § 138.052(2)(a)2, penalties are permitted in connection with prepayments made within five years of the date of a loan.[4] Under § 138.052(2)(a)3, penalties are prohibited with respect to prepayments made five years or more after the date the loan is made. The Wisconsin Statute thus applies the same penalty provisions to variable-rate residential loans tied to a non-approved index as generally apply to fixed-rate residential loans, but carves out a 30-day period after each interest rate adjustment during which any such loan, regardless of its age, may be prepaid without penalty.

An even stricter rule is applied by the Wisconsin Statute to variable-rate residential loans tied to an approved index. Such loans may never be assessed a prepayment penalty.

II. Discussion

The Parity Act authorizes state-chartered depository institutions and other nonfederally chartered "housing creditors" to "make, purchase, and enforce" alternative mortgage transactions without regard to any state constitution, law, or regulation.[5] The Parity Act defines the term "alternative mortgage transaction" to

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[4] Wis. Stat. § 138.052(2)(a)2 also sets forth a formula for determining the maximum penalty permitted with respect to prepayments on residential mortgage loans made within the first five years of the date of a loan.

[5] 12 U.S.C.A. § 3803 (West 1989). There is, however, one exception to the Parity Act's preemption of state law relating to alternative mortgage transactions. The Parity Act gave states three years following its enactment to override, or to "opt out" of, its federal preemption. 12 U.S.C.A. § 3804(a) (West 1989). It is our understanding, based on information you provided to the OTS Central Region, that Wisconsin did not opt out of the Parity Act.

include variable-rate loans secured by residential real estate.[6]

When transactions are undertaken in reliance on the Parity Act, however, they must be made in conformity with regulations governing alternative mortgage transactions issued by the federal banking agencies.[7] State banks and state credit unions lending in reliance on the Parity Act must do so in accordance with regulations governing alternative mortgage transactions issued by, respectively, the Office of the Comptroller of the Currency ("OCC") and the National Credit Union Administration ("NCUA"). All other "housing creditors," including state-chartered savings associations, lending in reliance on the Parity Act must do so in accordance with "regulations governing alternative mortgage transactions as issued by the [OTS]" for federal savings associations.[8]

The question presented is whether a state housing creditor that originates a variable-rate mortgage loan in conformity with the appropriate federal regulations would nevertheless be subject to the prepayment penalty restrictions of the Wisconsin Statute. The preemptive language in the Parity Act reads as follows:

> An alternative mortgage transaction may be made by a housing creditor in accordance with [the Parity Act], notwithstanding any State constitution, law, or regulation.[9]

Beyond this brief statement, the Parity Act provides no explicit guidance regarding the types of state laws Congress intended to preempt. On the one hand, it is clear that certain state laws, such as those governing liens and foreclosure, still apply to loans originated under the Parity Act. State laws of this type apply even when loans are originated by federal thrifts. On the other hand, it is equally clear that a state law prohibiting the issuance of variable-rate loans would be preempted by the Parity Act. The Wisconsin Statute falls somewhere in between these two examples in its potential impact on alternative mortgage loans.

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[6] 12 U.S.C.A. § 3802(1) (West 1989).

[7] 12 U.S.C.A. §§ 3801(b), 3803(a) and (c) (West 1989).

[8] 12 U.S.C.A. § 3803(a)(3) (West 1989). The Parity Act "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law." S. Rep. No. 97-463, 97th Cong., 2d Sess. 55. 48 Fed. Reg. 23032, 23053 (May 23, 1983); see also 49 Fed. Reg. 43040, 43043 (October 26, 1984).

[9] 12 U.S.C.A. § 3803(c) (West 1989).

For guidance as to whether the Wisconsin Statute is one Congress intended to preempt, we believe it is appropriate to look to the purposes that underlie the Parity Act. The Parity Act expressly states that Congress wished to "prevent discrimination against State-chartered depository institutions and other nonfederally chartered housing creditors, with respect to making, purchasing and enforcing alternative mortgage transactions. . . ."[10] At the time the Parity Act was enacted, federally-chartered depository institutions had already been authorized to engage in alternative mortgage transactions under regulations adopted by the federal banking agencies. The Parity Act states that:

> It is the purpose of this [Act] to eliminate the discriminatory impact that those [federal] regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.[11]

Under OTS regulations, federal thrifts are permitted to impose prepayment penalties at any time and in any amount authorized by their loan contracts.[12] For these purposes, no distinction is drawn between variable-rate and fixed-rate mortgage loans. Thus, unlike lenders operating under the Wisconsin Statute, federal thrifts are <u>not</u> required to provide a 30-day window after each interest rate adjustment within which borrowers may prepay variable-rate loans without penalty, nor are federal thrifts prohibited from imposing prepayment penalties after the fifth anniversary of the origination of the loan.

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[10] 12 U.S.C.A. § 3803(a) (West 1989).

[11] 12 U.S.C.A. § 3801(b) (West 1989).

[12] 12 C.F.R. §§ 545.34(c) and 556.11. The Parity Act directs the OTS, OCC, and NCUA to identify which of their lending regulations do not apply to housing creditors making loans under the Parity Act. Section 807(b) of Pub. L. 97-320, 12 U.S.C.A. § 3801 note. In § 545.33(f) of its regulations, the OTS has identified those OTS regulations that apply to housing creditors and has indicated that no other OTS regulations apply. The OTS's prepayment penalty regulations are not included in the list of applicable restrictions. Recently, the OTS issued a proposed rulemaking that would expressly incorporate the prepayment penalty regulations. 61 Fed. Reg. 1162, 1179 and 1181 (Jan. 17, 1996) (to be codified as 12 C.F.R. §§ 560.34(b) and 560.210). This is not a substantive change, but is being proposed to eliminate possible confusion. The Parity Act operates to preempt the Wisconsin Statute, leaving housing creditors free to impose prepayment penalties as provided in their loan contracts, unless restricted by OTS regulations. The practical effect of incorporating OTS's permissive prepayment penalty provisions will be to confirm that no OTS restriction was intended by the omission of such provisions from § 545.33(f).

If state housing creditors were required to follow the Wisconsin Statute when making variable-rate mortgage loans, they would clearly be disadvantaged vis-a-vis federal thrifts -- the very result Congress intended to prevent. The Wisconsin Statute thus appears to fall within the scope of laws preempted by the Parity Act. Accordingly, state savings associations and state housing creditors that are not state banks or credit unions and that originate variable-rate loans in conformity with all applicable OTS regulations need not comply with the Wisconsin Statute.

In reaching the foregoing conclusions, we have relied upon, among other things, the materials you submitted to the OTS Central Region. Our conclusions depend upon the accuracy and completeness of the information contained in such materials, as summarized herein.

If you have any questions regarding the foregoing, please contact Evelyne Bonhomme, Counsel (Banking and Finance), at (202) 906-7052.

Very truly yours,

Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
All Regional Counsel