



The State of South Carolina

Department of Consumer Affairs

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ADMINISTRATIVE INTERPRETATION 10.103-9302

THE CONSUMER PROTECTION CODE DOES NOT REQUIRE CREDITORS TO REBATE ORIGINATION FEES, DISCOUNT POINTS OR OTHER PREPAID FINANCE CHARGES UPON PREPAYMENT OF A LOAN SECURED BY A FIRST LIEN ON REAL ESTATE. THE CODE GIVES THE ADMINISTRATOR THE POWERS OF CHAPTER SIX TO INTERVENE IF SUCH FEES ARE EITHER EXCESSIVE OR UNCONSCIONABLE.

SECTION 37-10-102(b) RESTRICTS CHARGES WHICH MAY BE ASSESSED IN ASSUMPTIONS OF CONSUMER PURPOSE LOANS SECURED BY FIRST LIENS ON REAL ESTATE, AND IT DOES NOT ALLOW FOR EITHER COURIER FEES OR "TAX SERVICE" FEES AS PERMISSIBLE ADDITIONAL CHARGES. NO PROVISION OF THE CODE OTHERWISE RESTRICTS COURIER FEES OR "TAX SERVICE" FEES ON LOANS SECURED BY FIRST LIENS ON REAL ESTATE, ALTHOUGH OTHER CONSIDERATIONS MAY.

The Department has been requested, by two different parties, to answer three questions, two of which are so similar they will both be treated together. They are:

- 1.) Is there any requirement under the Consumer Protection Code for a supervised lender to rebate any portion of a loan origination fee upon prepayment of a first lien mortgage loan when such mortgage loan was incurred for personal family or household purposes?
- 2.) Do the provisions of Section 37-3-210, Section 37-3-105(2)(c), or other provisions of the Code, require a creditor to refund or rebate any portion of origination fees, discount points or other prepaid finance charges on prepaid first mortgage loans, including those which were not made to enable the debtor to buy or build a residence?
- 3.) Do the provisions of Section 37-3-202, or any other provision of the Code, prohibit a creditor from charging tax service fees and airborne freight fees on first mortgage loans?

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I. Prepaid Finance Charges As Prepayment Penalties In First Mortgage Loans

This Department has consistently taken the position that for consumer loans, "origination fees" or other prepaid finance charges are merely part of the finance charge and are subject to refund the same as any other part of the finance charge. See Administrative Interpretation No. 3.109-8010. This is still the Department's position. The requesting parties, however, correctly point out that loans secured by first or equivalent lien security interests in real estate are excluded from the definition of "consumer loan" as set forth in S. C. Code Ann. §§ 37-3-104 and -3-105(1) (Supp. 1992). Moreover, § 37-3-102, the scope of Chapter Three, applies the Chapter only to "consumer loans," although it adds "in addition Part six applies to loans other than consumer loans." Thus, the requestor reasons, the rebate provisions of § 37-3-210 cannot be applied to first mortgage loans, and if the assessment of non-rebatable prepaid finance charges is prohibited, it is not § 37-3-210 that prohibits it. We agree.

With the exception of loans made subject to the Consumer Protection Code by agreement, the only restrictions on finance charges on non-consumer loans (such as consumer purpose first mortgage loans) are found in Chapter 10 of Title 37, except as such fees might be subject to administrative powers pursuant to § 37-3-105(2)(c).

The initial question this poses is whether Chapter 10 requires the rebate of "unearned" prepaid finance charges. Section 37-10-103 states, in pertinent part:

With respect to a loan agreement which is secured in whole or in part by a first or junior lien on real estate under which the aggregate of all sums advanced or contemplated by the parties in good faith to be advanced will not exceed one hundred thousand dollars:

(1) The debtor has the right to repay the debt at any time without penalty....

The issue arises whether this provision, like §§ 37-3-209 and -210, effectively prohibits the retention of prepaid finance charges upon prepayment because such a retention would cause the creditor to have collected charges exceeding the amount allowable by application of the annual percentage rate to the amount financed for the actual time the debt was outstanding [§ 37-3-210(5)(a) and (b)], thereby, in effect, assessing a prepayment penalty [§ 37-3-209]. We are not convinced that Section 37-10-103 requires this result.

In non-precomputed consumer loan transactions, it is nearly irrelevant to speak in terms of prepaid finance charges. While a creditor is free to assess prepaid finance charges, it must be

prepared at any time prepayment occurs to account for any discrepancy between the amount of money actually collected and the amount which would have been properly collected by application of the annual percentage rate to the actual unpaid balances as of and up to the date of prepayment. Practically, consumer loan creditors charging prepaid finance charges must either have the capability of reproducing the "APR" balance by computer or by hand calculation, or be prepared to utilize charts or tables as provided in § 37-3-210(5)(b). A gross balance including prepaid finance charges would be of little value without the ability to account for the unearned portion of the prepaid finance charges.

It is noteworthy that for the consumer loans, the General Assembly found it necessary to tie both the calculation of the initial rate maximum and the calculation of earned and unearned finance charges to the disclosed annual percentage rate determined according to the Truth in Lending Act. See §§ 37-3-210(5)(a) and (b) and -305(2), respectively. This is not true with first mortgage loans, particularly home acquisition first mortgage loans. For such loans, there is no restrictions on the maximum finance charge allowed. S. C. Code Ann. § 37-3-605. One requester indicated that this section likewise implies there is also no restriction on how any portion of the loan finance charge is charged or earned. In the most extreme application of this concept, a lender could characterize the entire finance charge as prepaid and thereby earned at the time of closing. This would make § 37-10-103(1) a meaningless restriction.

Chapter 10 provides no direct restrictions on what may be assessed or earned as prepaid finance charges. The provisions aside from Chapter 10 which sets forth the application of the title to first mortgage loans are set forth in § 37-3-105(2), which states:

- (2) Loans excluded from the definition of a "consumer loan" pursuant to subsection (1) shall nevertheless be subject to the following provision of this title:
 - (a) Civil liability for violation of disclosure (§ 37-5-203);
 - (b) Voluntary complaint resolution (§ 37-6-117);
 - (c) Whenever the primary purpose of the credit extended is not to enable the debtor to buy or build a residence on residential real property, the administrative powers in Part 1 of Chapter 6. If an origination charge, prepaid finance charge, prepaid points, service or other prepaid charge for a particular type of loan, the creditor is subject to the provisions of Part 1, Chapter 6 of Title 37, notwithstanding that the origination charge, prepaid finance charge, prepaid points, service, or other prepaid charge is properly disclosed as part of the finance charge for the purposes of complying with

the Federal Truth-in-Lending Act of part or all of the origination charge, prepaid finance charge, prepaid points charge, service, or other prepaid charges are rebatable or refundable upon prepayment or acceleration of the obligation. For the purpose of this paragraph, a creditor is not subject to any liability if the loan finance charge and other fees and charges imposed by the creditor and the collection practices followed in administering or enforcing the loan are usual and customary for the particular type of loan. A charge, collection practice, or administrative procedure that is authorized or required by any state or federal statute or regulation relating to mortgage loans; or in any official manual setting forth the procedures for real estate mortgages issued by any governmental or quasi-governmental organization that purchases, insures, or guarantees such loans, including without limitation, manuals issued by the Federal Housing Administration, Federal National Mortgage Association, Government National Mortgage Association, Federal Home Loan Corporation or by any organization that regularly insures mortgages and is authorized to conduct such business in this State, is deemed to be usual and customary.

As amended by § 1 of Act 153 of 1985 and §8 of Act 142 of 1991.

Examination on of this provision may cast light on how the General Assembly believed that prepaid finance charges should be limited. Subsections (2)(a) and (b) merely re-affirm the pre-existing provisions providing for civil liability for violation of Truth in Lending disclosure provisions and provisions for voluntary complaint resolution. Non-purchase money consumer purpose first mortgages, however, were made subject to the Administrative powers of Part 1 of Chapter 6 of the Consumer Protection Code. By the amendment of Act 153 of 1985, however, the Administrator's power is extended specifically to consideration of prepaid charges. The amendment is not a model of clarity.

While South Carolina has no legislative history as such, some historical reference may assist in determining the legislative intent. Act 385 of 1982, also known as the Consumer Protection Code Revision Act, amended the Code in a number of ways. Most significantly, finance charges for most forms of consumer credit were deregulated, allowing creditors to charge any rate of finance charge that the market would bear for which the creditor was willing to file and post its rate maximums. In the wake of this deregulation, certain companies entered South Carolina and took advantage of the deregulated rates by charging extremely high annual percentage rates both in South Carolina and throughout the

Southeast. These companies not only charges high rates, but also charged a high number of discount points and other prepaid finance charges. This created an opportunity for the companies' personnel to induce borrowers to enter into the transactions by representing that a lower "interest rate" applied to the transaction - the rate applied to a principal containing both the money actually lent and the excessive number of discount points. See e. g. In re: Landbank Equity Corp., 66 B. R. 949 (E. D. Va. 1986), a'ffd. in part, remanded in part 83 B. R. 362 (E. D. Va. 1987); Garrison v. First Federal S. & L. Ass'n., 241 Va. 335, 402 S. E. 2d 25 (1991). Against this background Act 153 of 1985 was enacted. The General Assembly appears to have been concerned not only with the potential to mislead borrowers as to the true rate of finance charge by the use of excessive points, but also that the excessive points in themselves could make the transactions unaffordable.

Also, the issue of what power the General Assembly intended to give the Administrator is not entirely clear. To the extent a lender could be found to be assessing prepaid charges substantially exceeding the usual and customary as set forth, the lender is subject to Part 1 of Chapter 6. Part 1 of Chapter 6, however, deals mostly with the Administrator's power to remedy Code violations not otherwise applicable to first mortgage loans.

It is the opinion of this Department that the General Assembly, at least, intended to give the Administrator power to address agreements calling for excessive prepaid charges as unconscionable agreements (§ 37-6-111) or as excess charges remediable by lawsuit (§ 37-6-113) or by cease and desist order (§ 37-6-108).

Section 37-3-105(2)(c) also indicates that it is no defense to the Administrator's action to show that part or all of the prepaid charges were refundable or rebatable. If most such transactions were already covered by Section 37-10-103, and if it prevented retention of prepaid charges as a prepayment penalty, that provision of Section 37-3-105(2)(c) would have been irrelevant and misleading.

In addition, Section 37-3-105(2)(c) evidences the General Assembly's deference to those prepaid charges allowed by and customarily charged in the secondary market. This Department has previously recognized this deference in Administrative Interpretation 10.103(1)-8401. It is not unusual for a loan originator of first mortgage loans to be compensated fully or in part from prepaid finance charges, and for secondary market purchasers to make their decisions to purchase primarily on the examination of the note. The purchaser may or may not have knowledge of the existence or amount of the prepaid charges. Secondary market purchases are made on highly standardized forms and instruments to be marketed in pools of transactions from the various states. This Department is not aware of any state which limits prepaid charges or requires a rebate of a portion of prepaid

charges on home acquisition first mortgage loans bought and sold on the secondary market. It is not lightly to be assumed that the General Assembly would impose restrictions on the flow of such transactions by restricting retention of points as prepayment penalty. The Department is convinced that a rebate of unearned prepaid finance charges is not required by § 37-10-103, but that excessive or unconscionable prepaid charges are remediable under § 37-3-105(2).

II. Tax Service and Airborne Freight Charges

There are two responses to the third question. For transactions which are assumptions of first mortgage transactions under Chapter 10, the assessment of such fees are effectively prohibited as impermissible additional charges. Section 37-10-102(b)(i)-(iii) limits the charges assessable in assumption transactions to those allowable under § 37-3-202, plus specifically enumerated assumption and credit report fees. No courier fees or tax service fees are mentioned.

For non-assumption first mortgage loans under Chapter 10, there is no specific regulation of such fees in the Consumer Protection Code. To the extent such fees were found to be usual and customary charges, presumably the Code does not restrict them save to the extent the charges might substantially exceed the usual and customary charges as set forth in § 37-3-105(2)(c). Other factors may restrict them, however. To our knowledge, a "tax service fee" is a charge made to the borrower for having a third party ensure either that tax payments are made to officials in a timely manner or that tax bills are forwarded to the lenders for payment in a timely manner. If assessed in the context of a typical mortgage escrow account, one would have to examine the particular mortgage documents. An escrow is often a fiduciary relationship, in which amounts of money are paid to the lender or holder for the specific purpose of having the lender forward those amounts to insurers or tax officials. See Carpenter v. Suffolk Franklin Savings Bank, 362 Mass. 770, 291 N. E. 2d 609 (1973). In the proper context, a charge to the borrower to have a third party forward that money or assure its payment may violate that fiduciary duty. In any case, to the extent a charge is assessed in excess of what is actually forwarded to third parties the charge would appear to exceed the "usual and customary" under Section 37-3-105(2)(c).

In conclusion, it is the opinion of this Department that the Consumer Protection Code does not require creditors to rebate origination fees or discount points upon prepayment of loans secured by first liens on real estate. To the extent such charges might be excessive or unconscionable they may be addressed by the Administrator's powers under Chapter Six pursuant to § 37-3-105. Section 37-10-102 (b) does not permit either courier fees or "tax service" fees to be assessed as permissible additional charges in

assumption transactions. The Code does not restrict such fees in other first mortgage transactions, but other considerations may.

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ADMINISTRATOR

A handwritten signature in black ink, appearing to read "Philip S. Porter", written over a horizontal line.

by: Philip S. Porter
Deputy for Regulatory Enforcement