

31-17-1 and 31-17-8  
46A-1-102  
46A-3-109 and 46A-3-111  
46A-4-107 and 46A-4-112  
47-6-5  
47-6-5b  
47-6-5d  
47A-1-1

January 10, 1997

Re: Interpretive Letter on Second Mortgage Law

Dear Mr. :

This letter is in response to your inquiry of November 6, 1996 requesting clarification over several issues arising from recent changes to West Virginia law governing second mortgage lending and regulated consumer lending. (SB 6, SB 366 and HB 4624 and codified at W. Va. Code §§ 31-17-1 et seq. and 46A-1-101 et seq.).

As your letter poses several questions, let me respond to each separately in turn. You first ask:

1. "Whether broker fees and other additional charges permitted by the SMLL [Secondary Mortgage Loan Law] must be refunded upon prepayment?"

*Answer- Broker fees are not additional charges under the SMLL. W. Va. Code § 31-17-1(7) defines the term "additional charges" in a manner coextensive with that set forth in the WVCCPA at § 46A-3-109, but more importantly defines the term "finance charge" as coextensive with that for "loan finance charge" in the WVCCPA at § 46A-1-102. (SMLL at § 31-17-1(8)). The WVCCPA definition of "loan finance charge" means:*

the sum of (i) all charges payable directly or indirectly by the debtor and imposed directly or indirectly by the lender as an incident to the extension of credit, including any of the following types of charges which are applicable: Interest or any amount payable under a point, discount, or other system of charges, however denominated, premium or other charge for any guarantee or insurance protecting

the lender against the consumer's default or other credit loss; and (ii) charges incurred for investigating the collateral or credit worthiness of the consumer **or for commissions or brokerage for obtaining the credit, irrespective of the person to whom the charges are paid or payable, unless the lender had no notice of the charges when the loan was made.** The term does not include charges as a result of default, additional charges, delinquency charges or deferral charges. [W. Va. Code § 46A-1-102(26)(a) emphasis added].

*Thus broker fees are treated as finance charges under the SMLL and not as additional charges subject to the 10% limitation in W. Va. Code § 31-17-8(a)(3). The rebate upon prepayment requirement in W. Va. Code § 31-17-8(a)(1) relates to “unearned finance charges,” however, and since additional charges are by definition not finance charges, those fees properly qualifying as additional charges are not subject to rebate under that section. (Note- Unearned premiums for credit insurance, although an additional charge, must be rebated or otherwise applied to the loan pursuant to W. Va. Code § 46A-3-109). It should also be noted that although broker fees are treated as a finance charge, typically such broker fees are viewed as earned upon payment for the services rendered, and are therefore also not generally subject to rebate. But, where the broker fees together with points in a SMLL transaction exceed the 5% limit in W. Va. Code § 31-17-8(a)(1), they will be strictly viewed and will not automatically be considered “earned” (see Answer to question 6 below).*

2. “Whether SMLL licensees may charge a prepayment penalty on simple interest subordinated mortgage loans?”

*Answer- While it is true that the SMLL does not directly state that prepayment penalties are prohibited, (see W. Va. Code § 31-17-8(a)(1)), the WVCCPA, as amended, clearly does make prepayment penalties unlawful in second mortgage lender licensee contracts. In subsection (2) of W. Va. Code § 46A-3-110 it specifically states that “said prepayment penalty **may not be imposed as part of any industrial loan company licensee or secondary mortgage lender licensee contract....” Id. (emphasis added).** Note, however, that if a second mortgage licensee were to take an assignment of a second mortgage loan originally made by a bank or other entity exempt from the SMLL, which loan contained a prepayment penalty of 1% in its first three years as permitted by the WVCCPA, then the licensee could enforce that provision. It is also our position that a SMLL licensee may have in its first mortgage contracts the prepayment penalty permitted by W. Va. Code § 46A-3-110(2), since the restriction therein is intended only to apply in connection with their second mortgage loans. In contrast, the prohibition against industrial loan company licensees (now called Regulated Consumer Lender Licensees) imposing a prepayment penalty applies to all loans that they make, including all first mortgage loans. (See W. Va. Code § 46A-4-107(3)(making all loans made by RCLs regulated consumer loans)).*

3. “Whether SMLL licensees must include ‘points’ along with additional charges when calculating the 10% maximum on additional charges or the 18% per year maximum interest rate?”

*Answer- SMLL licensees are limited to 18% APR which calculation must include any charges for points, (points are viewed as finance charges under both the WVCCPA and the federal Truth-in-Lending Act - TILA); and may further charge 10% in certain additional charges, which charges are not part of finance charges under the WVCCPA and TILA. Thus **points** are included in the APR calculation as part of the finance charge, but **are not included in the additional charge cap**. It should also be recognized that not all additional charges are counted as part of the statutory 10% cap. These permitted uncapped additional charges are for official fees and taxes and insurance as allowed by W. Va. Code § 46A-3-109. As a practical matter the 10% cap is intended to limit those ‘reasonable’ closing costs in second mortgage loans which are unrelated to official fees and taxes, and which are excluded from finance charges in loans secured by residential mortgages under the WVCCPA and TILA.*

4. “Whether Usury law permits a prepayment penalty on first mortgage loans relying on the federal preemption?”

*Answer- The rates permitted by W. Va. Code §§ 47-6-5(c) and 47-6-5b(f), which condition their imposition on there being no prepayment penalties are not exclusive, and indeed specifically state that they are “an alternative to ...any interest rate authorized by any other provision of this Code.” *Id.* Mortgage loans are consumer loans covered under the WVCCPA unless they are for a business purpose (e.g., an office building). See W. Va. Code § 46A-1-102(15). First mortgage loans to consumers are thus generally subject to the provisions of W. Va. Code § 46A-3-110 which permits but limits prepayment penalties. This section, as amended, makes clear that first mortgage loans may carry a 1% prepayment penalty in the first three years of the loan. (But note, that the lender may not impose the penalty if it is refinancing its own loan within the first twelve months. This is to prevent lenders from encouraging their borrowers to refinance in anticipation of obtaining such penalties.) Given the West Virginia Lending & Credit Rate Board order pursuant to W. Va. Code § 47A-1-1 et seq., it is without dispute that a first mortgage lender may charge 18% APR and have a 1% prepayment penalty as provided for in the WVCCPA. It is similarly our view that **a first mortgage company acting under the federal preemption in DIDMA would be able to charge the prepayment penalty set forth in the WVCCPA**. Prepayment penalties may not, however, be charged by regulated consumer lender licensees in their first mortgage loan contracts or any of their other contracts. (See W. Va. Code § 46A-3-110(2), -4-107(3) and -4-112).*

5. “Whether the Usury law restricts points on first mortgage loans or requires the rebate of points upon prepayment, except for a refinancing by the same lender within twenty-four months of the original loan?”

*Answer- The usury code provision in W. Va. Code § 47-6-5d works together with W. Va. Code § 46A-3-111 of the WVCCPA to create the following result: Non-purchase money loans made by a first mortgage company or other non-bank entity may charge any amount of points, but if the loan is repaid early they can only retain five points and the rest are subject to rebate using the actuarial method. Sometimes, however, even this five point amount cannot be retained. Where the lender has already charged and retained its five points, it may not upon a subsequent refinancing retain any additional points unless that loan is two or more years old. This additional restriction, set out in the usury law at W. Va. Code § 47-6-5d(c), is meant to prevent a lender from doubling or tripling-up the points charged to the consumer within a short period of time. Separate provisions limit Regulated Consumer Lender licensees and SMLL licensees to charging a maximum of five points, W. Va. Code §§ 46A-4-107(4) and 31-17-8(a)(1), respectively. Lastly, it should be noted that the **DIDMA preemption on points for purchase money first mortgage loans still applies** and thus the state law restrictions on points do not generally impact such loans **except when made by a Regulated Consumer Lender licensee or made to abet such a licensee evade their restrictions.***

(6) “Does the WVCCPA limit points to 5% for any first mortgage loans and, if so, must broker fees be included in the 5%?”

*Answer- As explained above in response to question 5, not all first mortgage transactions are subject to the state’s restrictions on points. While all first mortgage loans by a Regulated Consumer Lender are subject to the 5 point limitation in W. Va. Code § 46A-4-107(a)(4), a first mortgage loan by a SMLL licensee is not subject to the 5 point limitation in W. Va. Code § 31-17-8(a)(1) since that section only refers to second mortgage loans by the SMLL licensee. A first mortgage loan by a SMLL licensee or mortgage loan company, however, is still subject to the rebate provisions in W. Va. Code § 47-6-5d(c) for the excess of more than 5 points, unless the loan is a purchase money loan. Broker fees may be paid out of the assessed points, and lenders are encouraged to do so. In splitting the points with the broker, such split should be disclosed in the itemization of the amount financed as a prepaid finance charge. **To the extent that the broker fees are paid to an affiliate of the lender, they must be counted as a portion of the 5% points and origination fee limitation.** Where the sum of the broker fees and points levied in connection with a covered first mortgage loan exceeds 5% of the amount financed, this office will view such overages with disfavor, and strictly scrutinize whether a brokerage fee in such circumstances is properly an “earned” finance charge at the time of the loan and thus exempt from the rebate provisions of W. Va. Code § 47-6-5d.*

I hope that these answers are responsive to your concerns. If you have any further questions regarding these matters, please let me know.

Sincerely,

Timothy C. Winslow  
General Counsel