Office of Thrift Supervision
Department of the Treasury

Chief Counsel

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

October 20, 1995

[redacted]

RE: Alternative Mortgage Transaction Parity Act - Application to Loans Made in California

Dear [redacted]

This responds to your inquiry raising two questions regarding the applicability of the federal Alternative Mortgage Transaction Parity Act of 1982 (the "Parity Act"), which preempts certain state lending laws, to adjustable rate loans made in California by private parties and real estate brokers.

In brief, our conclusions are as follows. First, California did not override the preemption of state law provided by the Parity Act with respect to alternative mortgage transactions. Second, a natural person or real estate broker may be considered a "housing creditor" under the Parity Act if he or she "regularly makes" loans secured by an interest in residential real estate. A "housing creditor" will be deemed to "regularly make" loans for purposes of the Parity Act if he or she makes more than five loans secured by an interest in real estate in the preceding or current calendar year.

I. Background

[redacted] (the "Company"), creates software for use by nontraditional lending sources in California. The Company has developed a product that generates loan documents for adjustable rate mortgages and other types of alternative mortgage instruments. In addition, the Company lends its own funds to, and brokers loans for, individual lenders.

Your inquiry focuses on licensed real estate brokers and private parties who use the services of licensed real estate brokers to arrange adjustable rate loans in California. You indicate that these brokers and private parties may make only one loan in some years and more in others.

You argue that the Parity Act's preemption of state laws relating to alternative mortgage transactions by housing creditors, including natural persons, applies in California. In support of your argument, you state that, based upon your review of various California Civil Codes, California did not effectively override the preemption provided by the Parity Act.

You also argue that a private party who makes more than one loan secured by real estate in any year qualifies as a "housing creditor" under the Parity Act during that year. You state that the Congressional intent behind the Parity Act was to ensure that consumers have an adequate supply of credit at affordable rates, and thus to extend parity to <u>all</u> housing creditors, regardless of size or financial ability. Consequently, you reason that any person who makes more than one loan a year "regularly makes" loans under the Parity Act's definition of "housing creditor."

II. Discussion

The Parity Act, enacted as Title VIII of the Garn-St Germain Depository Institutions Act of 1982,[1] authorizes all "housing creditors" to make, purchase, and enforce alternative mortgage transactions[2] without regard to any state constitution, law, or regulation, provided the transactions are in conformity with certain federal lending regulations.[3] State banks lending in reliance on the Parity Act must follow regulations issued by the Comptroller of the Currency for alternative mortgage transactions. State credit unions must follow regulations issued by the National Credit Union Administration for alternative mortgage transactions. All other "housing

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[1] Pub. L. 97-320, 96 Stat. 1469 (1982), codified at 12 U.S.C.A. § 3801 <u>et seq.</u> (West 1989 & West Supp. 1995).

[2] An "alternative mortgage transaction" is a loan or credit sale secured by residential real property, a dwelling, the stock of a residential cooperative housing corporation or a residential manufactured home (i) in which the interest rate or finance charge may be adjusted or renegotiated, (ii) which involves a fixed-rate, but which implicitly permits rate adjustments, or (iii) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, defined by applicable regulation. 12 U.S.C.A. § 3802(1).

[3] 12 U.S.C.A. § 3801(b) and 12 U.S.C. § 3803.

creditors" must follow regulations issued by the Office of Thrift Supervision ("**OTS**") for alternative mortgage transactions.[4]

The Parity Act thus preempts state law relating to alternative mortgage transactions and provides nonfederally chartered housing creditors parity with federally chartered institutions subject, however, to one exception. The Parity Act gave states three years following its enactment to override, or to "opt out" of, its federal preemption.[5]

A. Applicability of the Parity Act in California

The "opt out" provision of the Parity Act provides that a state decision to override the Act had to be in the form of "a State law or a certification that the voters of such state have voted in favor of any provision . . . which states explicitly and by its terms that such State does not want the preemption provided in section 3803 [of the Parity Act]. . . to apply with respect to alternative mortgage transactions . . . subject to the laws of such State . . . ."[6]

Less than two years after enactment of the Parity Act, California enacted legislation intended to prevent inequities between state and federal financial institutions doing business in California by creating mortgage parity procedures. That legislation authorized state regulatory officials to prescribe regulations "extending to lenders who make loans . . . [secured by] residential real property any right, power, privilege or duty relating to [the] mortgage instrument equivalent to authority extended to federally-regulated financial institutions by federal statute or regulation."[7]

However, the legislation is devoid of any "explicit" statement, as required by the Parity Act, that the State of California "does not want the preemption provided in § 3803 [of the Parity Act] to apply with respect to alternative mortgage transactions" originated by California lenders. Indeed, the statute does not even reference or allude to the Parity Act or the preemption provided by the Parity Act. Rather, the California

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[4] 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); <u>see also</u> 49 Fed. Reg. 43040, 43043 (October 26, 1984).

[5] 12 U.S.C.A. § 3804(a).

[6] <u>Id.</u>

[7] Cal. Civ. Code § 1916.12(b) (Deering 1995).

statute appears to be an attempt by the State to accord state lenders parity with federal institutions without acknowledging the Parity Act's preemption of state law.

In light of the foregoing, we conclude that the State of California did not opt out of the preemption provided by the Parity Act. This conclusion is consistent with an opinion issued by the Legislative Counsel of California stating that "California has adopted no law that states explicitly and by its terms that the federal . . . [Parity Act] should not apply in the state."[8] Accordingly, the Parity Act's preemption applies with respect to "housing creditors" engaging in alternative mortgage transactions in California.

B. Meaning of "Housing Creditor" Under the Parity Act

The Parity Act defines a "housing creditor" as a depository institution, a lender approved by the Secretary of Housing and Urban Development for participation in certain mortgage insurance programs, "any person who regularly makes loans, credit sales, or advances secured by interests in properties referred to in . . . [the Parity Act], or any transferee of any of them" (emphasis added).[9]

The phrase "regularly makes" is not defined in the Parity Act. Neither the legislative history of the Parity Act nor case law provide guidance as to the meaning of the phrase. However, in the context of the federal preemption of state usury laws with respect to federally-related residential mortgage loans, the term "regularly" is defined. It is a well-established principle of statutory interpretation that statutes *in pari materia* should generally be construed together, and, as a result, provisions in one statute which are omitted in another on the same subject matter will be applied when the purposes of the two statutes are consistent.[10] Thus, in the absence of more definitive guidance, we believe it is appropriate to construe the term "regularly makes" as it appears in the Parity Act in the same manner as the term "regularly" is construed for usury preemption purposes.

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[8] Letter dated August 7, 1995 from B.M. Gregory, Legislative Counsel of California, to the Honorable John Vasconcellos at page 3 (original emphasis).

[9] 12 U.S.C.A. § 3802(2). This subsection also indicates that the Parity Act does not exempt any person from state licensing requirements. If state law requires a person to be licensed before making loans, that person must obtain a state license to qualify as a "housing creditor" under the Parity Act.

[10] 2B Sutherland, *Statutory Construction*, § 51.02, n. 10 (5th Ed. 1992).

The National Housing Act ("NHA") provides that state usury laws shall not apply to "federally-related mortgage loans."[11] This term is defined to include any loan that is secured by a first lien on residential real estate and that is made by any "creditor," as defined in the Truth in Lending Act ("TILA"),[12] who makes or invests in residential real estate loans aggregating more than $1 million per year.[13] The TILA definition of "creditor" requires that credit be extended "regularly." The definition has been interpreted by Federal Reserve Board ("FRB") at 12 C.F.R. § 226.2(a)(17)(i) and note 3.

FRB regulations provide that a lender will be deemed a "creditor" that "regularly" extends consumer credit if it engages in more than five transactions secured by a dwelling in the current calendar year or engaged in more than five such transactions in the prior year.[14] Thus, for usury preemption purposes, a lender is deemed to be a "regular" creditor if it makes more than five residential real estate loans in the current or prior year.

This same standard has been adopted in the Real Estate Settlement Procedures Act ("RESPA") and its regulations.[15] Under RESPA, the term "federally related mortgage loan" includes a "loan made by a 'creditor' as defined in [TILA] who makes

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[11] 12 U.S.C.A. § 1735f-7a(a)(1).

[12] 15 U.S.C.A. § 1602(f).

[13] 12 U.S.C.A. §§ 1735f-7a(a)(1)(C)(iii)and 1735f-5(b). See also implementing regulations at 12 C.F.R. Part 590 (1995).

[14] The FRB amended 12 C.F.R. § 226.2(a)(17) note 3 on March 24, 1995, to implement a consumer protection provision added to the TILA by the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325, 108 Stat. 2160, 2190-91 (1994). The current version of note 3 brings a greater number of lenders under TILA for consumer protection purposes. TILA now covers lenders engaging in high-rate or high-fee mortgage transactions if they made more than one such transaction within a "rolling" 12-month period (not a calendar year) pursuant to 12 C.F.R. § 226.32 ("Section 32 mortgage"). However, the section-by-section analysis of § 226.2(a)(17) note 3 makes clear that "[p]ersons making fewer than five home-secured loans during a calendar year--that do not meet the definition of a Section 32 mortgage--are not subject to the [A]ct." 60 Fed. Reg. 15,463, 15,464 (1995). In addition, the FRB staff has confirmed that the general rule for TILA coverage remains more than five transactions secured by a dwelling in the preceding or current calendar year. Amendment of Regulation Z, 60 Fed. Reg. 15,463, 15,471 (1995) (to be codified at 12 C.F.R. § 226.2(a)(17) n. 3).

[15] 12 U.S.C.A. § 2601 et seq. (West 1989 and West Supp. 1995) and 24 C.F.R. Part 3500 (1995).

or invests in residential real estate loans aggregating more than $1 million per year."[16] In referencing the TILA definition of "creditor," RESPA in effect adopts the FRB's interpretation that requires the lender to make more than five loans in the current or prior year in order to be deemed to "regularly" extend credit.

In light of the foregoing, we cannot agree that any person who makes as few as two loans per year "regularly makes" loans for purposes of preemption under the Parity Act. While Congress did not specifically impose the "more than five loans" requirement in the Parity Act, Congress specifically expressed its intent that preemption be extended only to lenders who "regularly make" residential real estate loans. In the absence of more specific guidance from Congress, we believe it is appropriate to use the same standard as is utilized in analogous statutory contexts to identify "regular" lenders.

In reaching the foregoing conclusions, we have relied on the factual representations contained in the materials you submitted to us and made by you in telephone conversations with staff, as summarized herein. Our conclusions depend on the accuracy and completeness of these representations. Any material change in facts from those set forth herein could result in different conclusions.

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

Very truly yours,

C J Buck

Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
All Regional Counsel

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[16] 12 U.S.C.A. § 2602(1)(B)(iv). See also 24 C.F.R. § 3500.2 (1995). The $1,000,000 standard that appears in both RESPA and the NHA is not part of the definition of "regular" creditor for purposes of those statutes. In other words, under those statutes, a lender must both be: (i) a regular creditor; and (ii) a lender who extends more than $1,000,000 in credit per year. A lender is deemed to meet the "regular" creditor prong of the test if it originates five loans in the current or prior year, regardless of the dollar volume of those loans. Thus, we do not believe that the $1,000,000 standard should be imported into the Parity Act for purposes of determining what constitutes a creditor who "regularly makes" loans.