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## Department of Justice

January 30, 1997

VIA FAX: 515/223-4031

RE: Mortgage broker points/lender points,  
Second Mortgages and Refinance of First Mortgages  
ICCC Inf. Adv. #81

Dear

Thank you for your inquiry. To sum up the following advisory letter, we would highlight the following points, which are expanded upon below:

1. As you indicate, mortgage broker fees are, and have always been, a finance charge under the ICCC, with one narrow exception.

2. Second mortgages of \$25,000 or under are subject to the ICCC, provided they meet the other criteria necessary to be a "consumer credit transaction."

3. First liens of \$25,000 or under, including those which refinance prior mortgages, are subject to the ICCC, provided they are otherwise consumer credit transactions. The exception to this is where the new loan refinances a contract for deed, which is not covered.

4. Those first liens of \$25,000 or under which refinance purchase-money mortgages, while generally subject to the ICCC, may nevertheless impose some charges in addition to those authorized by the ICCC.

5. Points -- by whatever name -- are not permitted in ICCC-covered closed-end second mortgages or those first mortgages which are not refinancings of acquisition-money mortgages.

6. Closed-end first mortgages of \$25,000 or under which refinance acquisition-money mortgages, while subject to the ICCC

generally,<sup>1</sup> may include two points (or one, in a same-creditor refinance), and an additional amount for a closing/commitment fee as agreed to by the parties. That would appear to encompass brokers points, provided the broker is being paid for services rendered.

7. HELCs of \$25,000 or under are subject to the ICCC generally, but a loan processing fee as agreed to by the parties may be charged. Again, that would appear to encompass lenders points, or brokers points, so long as the broker is being compensated for services rendered.

#### Mortgage Brokers Fees are a Finance Charge

Among its examples of a finance charge, the ICCC specifically lists charges "for commissions or brokerage for obtaining the credit, irrespective of the person to whom the charges are paid or payable, unless the creditor had no notice of the charges when the credit was granted." Iowa Code § 537.1301(19)(a)(4).

As the FRB staff noted in connection with the recent Truth in Lending amendment which makes mortgage broker fees a per se finance charge, information regarding a broker's fees is in the HUD-1 or HUD-1A.<sup>2</sup> Since the majority of residential mortgages are now covered by RESPA, the mortgage documents themselves would give the creditor notice of the fee.

You should also be aware that a federal district court has recently held that RESPA's anti-kickback provisions simply prohibit arrangements where the broker is compensated by the lender. At issue were yield-spread premiums, where the broker received or retained a portion of the points or interest rate charged in connection with the loan. *Mentecki v. Saxon Mortgage*, Civ. No. 96-1629-1 (E.D. Va., order denying defendant's motion to dismiss filed January 13, 1997). RESPA, of course, allows compensation to the broker for services actually performed; it merely prohibits compensation for referrals.

#### ICCC Applicability to Second Mortgages and Refinancing Firsts of \$25,000 or Under.

When we spoke on the phone, you indicated that there are mixed rumors "on the street" as to whether the Iowa Consumer Credit Code applies to second mortgages.

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<sup>1</sup> This letter presumes throughout that all of the other criteria to bring a transaction within the scope of the ICCC are present.

<sup>2</sup> 61 Fed. Reg. at 49238 (Sept. 19, 1996).

The ICCC applies to a loan transaction which meets all the following criteria:

It is

- a) primarily for personal, family, or household purposes;
- b) the loan is extended by a person regularly engaged in the lending business;
- c) the consumer is not an organization;
- d) the debt is either payable in installments or a finance charge is imposed; and
- e) the amount financed is \$25,000 or less.

Iowa Code § 537.1301(14).

Mortgage loans which otherwise meet the above criteria are excluded from the scope of ICCC only where following criteria are met:

- a) it is secured by a first lien, and
- b) it is incurred for one of the following purposes;
  - (i) to acquire the secured real property,
  - (ii) to refinance a contract for deed to the secured real property, or
  - (iii) to construct a dwelling on that real property.

Iowa Code § 537.1301(14)(b)(2).

Consequently, second mortgages of \$25,000 or under do not fall within that limited mortgage exclusion. If all the other criteria are met, they are subject to the ICCC.

Similarly, by the clear terms of the statute, a loan secured by a first lien which refinances prior credit will be excluded from coverage by the ICCC only where the prior credit was a contract for deed. Therefore, a loan refinancing a prior mortgage -- even if that prior mortgage was an acquisition money mortgage -- would be subject to the ICCC, again assuming all other criteria are met.<sup>3</sup>

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<sup>3</sup> This is consistent with the interpretation of the Truth in Lending Act with respect to refinancing purchase-money mortgages. Acquisition-money mortgages are exempt from TIL's rescission provisions, 15 U.S.C. § 1635(e)(1); Reg. Z § 226.23(f)(1). However, even if a loan refinances an acquisition-money mortgage, the subsequent refinancing loan is subject to TIL's rescission rules (unless it meets a narrow test where the refinancing is by the originating creditor, with no new advances.) Official Staff Commentary §§ 226.2(a)(24)-5 ("a transaction is not 'to finance the acquisition' of the consumer's principal dwelling (and therefore is not [an acquisition-money] residential transaction) if the consumer

Permissibility of Mortgage Broker Points or Lender Points on Closed-end Second Mortgages and Certain Non-Acquisition Money Firsts

Your question asks whether mortgage broker points or lender points could be imposed on a second mortgage or refinances of first mortgages.<sup>4</sup>

Assuming this is a closed-end second mortgage, neither type of prepaid finance charge would be permitted. The ICCC requires actuarial computation, Iowa Code § 537.2401, and prepaid finance charges are inconsistent with actuarial accounting.<sup>5</sup>

This would also be the case with first mortgages of \$25,000 or under which do not refinance purchase money firsts. (As the Banking Division interprets this, if the majority of the funds advanced in any downstream loan go to refinance what had originally been an acquisition-money mortgage, the new loan would refinance a purchase money first. If the majority of the funds are not so used, the new loan does not refinance a purchase money first.)

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had previously purchased the dwelling and acquired some title to the dwelling, even though the consumer has not acquired full legal title."). See also Official Staff Commentary 226.20(a)(5); 226.23(f)-4. It is also consistent with Iowa Code § 654.12B(2) (A refinance of a purchase money mortgage is not a purchase money mortgage except where it is between the same lender and borrower and no new funds are advanced.)

As is discussed below, however, "refinancing" is defined more broadly in Iowa Code § 535.8(1), and the Banking Division has harmonized Chapter 537 with section 535.8 by permitting charges authorized under §535.8 where there is overlapping coverage.

<sup>4</sup> Again, the remaining discussion assumes that the all of the basic requirements are met for a transaction to constitute a "consumer credit transaction."

<sup>5</sup> Cf. State of Kansas, Consumer Credit Commissioner, Admin. Interp. No. 107 (Jan. 2, 1985)(points prohibited except where explicitly authorized as inconsistent with actuarial computation requirement.) [Kansas is also a UCCC state.]

Similarly, at least where not explicitly authorized by statute, if points are charged, they are subject to rebate upon early termination of the transaction. Cf. Mass. Off. of the Commission of Banks, Admin. Bull. Ref. No. 8408, Aug. 31, 1984) (points in non-mortgage consumer loans were a precomputed charge subject to rebate requirements); S. C. Dept. of Consumer Affairs, Admin. Interp. No 3.109-8010 (Sept. 3, 1980).

Thus, first liens taken in conjunction with loans consolidating other types of debt would be treated the same as a second mortgage.

Permissibility of Mortgage Broker Points or Lender Points on Closed-end First Mortgages of \$25,000 or Under Which Refinance Prior Acquisition-Money Mortgages

As noted above, except where the transaction being refinanced was a contract for deed, these mortgages are subject to the ICC. However, Iowa Code §535.8, which applies to acquisition money loans, by its terms also includes the "refinancing of a contract for sale, and the refinancing of a prior loan." Iowa Code § 535.8(1).<sup>6</sup>

As such, with respect to permissible charges, there is some overlap between Chapter 537 and 535.8. In this specific category of first mortgages, the Banking Division has harmonized the two by allowing the charges specified in § 535.8.

That section authorizes a "loan processing fee" of two points, or only one point if it is a same-creditor refinancing. Iowa Code § 535.8(2)(a). Additionally, a commitment and/or closing fee may be imposed if agreed to in writing by the consumer. Id.

You asked whether it would be permissible to impose three points. For this type of transaction, you could charge only two points, but you may contract for an additional amount as a commitment and/or closing fee, if the borrower agrees.

While brokers are not mentioned, compensation to brokers from these authorized fees for services actually performed in processing the application and settlement (other than referral) would appear to be allowable.

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<sup>6</sup> See page 4 for the explanation of the Banking Department's interpretation of what transactions refinance purchase money loans within the meaning of Iowa Code § 535.8(1). (But see note 3, above, for interpretations in other contexts relevant to consumer transactions.)

Permissibility of Mortgage Broker Points or Lender Points on Equity Line of Credit

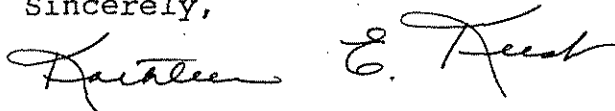
HELCS with initial credit lines of \$25,000 or under<sup>7</sup> are subject to the ICC, except for the ICC provisions specifically overridden by Iowa Code § 535.10(2) and (3).

The additional charges which may be imposed in a HELC are the closing costs which are spelled out in §535.8(2)(b), and a "loan processing fee" agreed to between the borrower and the lender. As noted above, to the extent that lender points or broker points are compensation for processing the loan, they would seem to be permitted.

Caveats

It should be noted that while there are not statutory limitations on the amount of commitment/closing fees in conjunction with §535.8 loans or loan processing fees in conjunction with §535.10 HELCs, in some jurisdictions reasonableness limitations have been read in. Further, in closed-end residential mortgages, such fees would count toward meeting the 8% "fees and points" trigger which determine whether the federal high-cost mortgage law applies.<sup>8</sup> And, as noted above, there is currently a significant amount of litigation relating to mortgage brokers' compensation and duties toward the borrowers.

Sincerely,



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Iowa Consumer Credit Code

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<sup>7</sup> Provided there is an express commitment on the lender's part to loan up to the initial credit limit without obtaining additional credit information on subsequent advances, it is the amount of the line's initial limit which determines whether the \$25,000 limit is exceeded. 61 IAC §16.1.

<sup>8</sup> 15 U.S.C. § 1639; Reg. Z §§ 226.31, 226.32.