

February 4, 1983

Dear

I am responding to your request for an Advisory Ruling concerning a mortgage company which may offer the Graduated Payment Adjustable Mortgage Loan (GPAML). Under this program, the consumer has a graduated payment mortgage loan in which the monthly payment is raised by a set amount over a certain time period. In addition, the interest rate is subject to adjustments pursuant to movements in an index similar to other AML transactions. In addition, the Graduated Payment Adjustable Mortgage Loan usually results in negative amortization.

You have asked whether a GPAML complies with the provisions of Section 3-308(1) of the Maine Consumer Credit Code which prohibits creditors from contracting for or receiving payments pursuant to a payment schedule under which one payment is not substantially equal to all other payments. As you noted, a supervised lender other than a supervised financial institution is not specifically exempt from Section 3-308 by virtue of the list in Section 1-202(8). On the other hand, you have also pointed out that the Code clearly contemplates variable rate transactions pursuant to Section 3-310. A necessary aspect of any variable rate transaction is that the consumer's monthly payment will be changed to reflect changes in an index which is determinative of the interest rate charged at any one time.

It is the opinion of the Bureau that the enactment of Section 3-310 (P.L. 1981, c. 138) should be interpreted to supersede any interpretation of Section 3-308(1) which would prohibit variation in payment amounts when the loan conforms to the regulatory provisions and disclosure requirements of Section 3-310.\* Section 3-310 provides clear legislative guidance on whether and how payments can be varied in response to changes in the interest rate.

This does not answer all the relevant issues, however. A GPAML involves not only an adjustable rate feature, but a graduated payment feature which does not depend on the movement of any index. The graduated payment feature of this transaction is not subject to Section 3-310 and is, therefore, subject to the requirement for substantially equal payments in Section 3-308(1). While there is no evidence that the Legislature considered and/or intended to prohibit graduated payment mortgages in Section 3-308, that section's prohibition on balloon payments (the so-called "partially amortized" mortgages), is certainly applicable to mortgage transactions. Whether or not a relatively small variation (i.e., 10% or less) in a payment schedule for a purchase money mortgage is substantial, is an issue of fact. While the Bureau feels comfortable with the 10% figure as a general rule, the Bureau is unprepared to approve the type of mortgage you suggest in which the monthly payment remains the same for years 1 through 3, increases 15% in year 4, and increases 7½% annually in years 5 through 10. This is a total increase in the monthly payment of over 50%. The Bureau is unable to classify this change as not substantial. The Bureau is, however, inclined to be more lenient in applying the equal payment rule in a mortgage situation which involves a long maturity and which is subject to regulation by other state and federal authorities.

You have also asked whether a mortgage company can provide for a delinquency charge for late mortgage payments where the loan does not include precomputed interest. Since the exemption in Section 1-202(8) includes Section 2-502 of the Code and Section 2-502 by implication prohibits late fees for simple interest transactions, there should be no question about your ability to impose late fees.

You have also asked how to comply with the provision of Section 3-310(1)(B) which requires the creditor to disclose the "length of time between written notification to the consumer of any increase in the annual percentage rate and the effective date of the increase." You are correct in your interpretation that this provision does not explicitly require a lender to provide that any length of time exists between a change in the interest rate on a loan and the effective date of that change. However, I am hopeful that you are not proposing to send consumers a notice concerning their new monthly payment and not inform them of the actual change in the index and the impact of this change on the interest rate being charged them. This would not be allowed pursuant to the regulations of the Bureau of Banking. See Rule 119, Section 4(D) which requires at least a 30-day notice of rate changes. I do not understand how you could operate a variable rate program without informing people of interest rate changes. I do, however, agree that a disclosure that "no length of time exists between the notification of interest rate change and the effective date of that change" would be allowed under Section 3-310(1)(B).

I hope that I have responded to your concerns.

Sincerely,

/s/ Barbara R. Alexander

Barbara R. Alexander  
Superintendent

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\*AR #88 Amendment

This Ruling is modified by repealing that part which relates to Graduated Payment Adjustable Mortgage Loans (GPAML), §3-308 and §3-310. P.L. 1983, c. 720, §§19 and 20 amended §3-310 to permit "alternative mortgage transactions" to be made by "non-bank" lenders, provided that the instruments were made in accordance with rules adopted by the Bureau. The Bureau has adopted Rule 250 to implement these provisions. GPAMLs are included in the Rule as alternative mortgage transactions. Subsection 6 of §3-310 provides that any loan made in accordance with Rule 250 is exempt from §3-310(1) and §3-308, among other sections.

7/14/86