REPORT OF THE
JOINT SUBCOMMITTEE STUDYING

The Revision Of The Interest Rate Laws Of The Commonwealth And Monitoring The Savings And Loan Laws And The Interstate Banking And Savings and Loan Laws Of The Commonwealth

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

House Document No. 28

COMMONWEALTH OF VIRGINIA
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Report of the Joint Subcommittee Studying the Revision of the Interest Rate Laws of the

Commonwealth and Monitoring the Savings and

Loan Laws and Interstate Banking and Savings

and Loan Laws of the Commonwealth

To: Honorable Gerald L. Baliles, Governor of Virginia
and
The General Assembly of Virginia

January, 1986

INTRODUCTION

The joint subcommittee studying the revision of the interest rate laws of the Commonwealth and the savings and loan laws and the interstate issue was established pursuant to House Joint Resolution No. 30 of the 1984 Session of the General Assembly. During the 1984 interim the subcommittee studied all three issues and recommended legislation to revise the savings and loan laws and to enact statutes regulating interstate banking and the interstate activities of savings and loan associations. Both of those bills were passed by the 1985 Session of the General Assembly and enacted into law. House Document No. 20 printed, January, 1985, is the report of the subcommittee on its work during the 1984 interim. The subcommittee recommended in that report that a resolution be passed by the 1985 General Assembly to continue the study of the subcommittee in order that it may further deliberate and consider the revision of the interest rate laws of the Commonwealth and to monitor the interstate activies of the banks and savings and loans in Virginia and to minitor the newly revised savings and loan statutes. The 1985 General Assembly passed House Joint Resolution No. 217 to continue the study and that resolution reads as follows:

HOUSE JOINT RESOLUTION NO. 217

Continuing the joint subcommittee study, established under House Joint Resolution No. 30 of 1984, to review the savings and loan laws, the interest rate laws of the Commonwealth and interstate banking.

WHEREAS, pursuant to House Joint Resolution No. 30 of the 1984 Session of the General Assembly, a joint subcommittee was established to study the issue of interstate banking, the revision of the savings and loan laws and the revision of the interest rate laws of the Commonwealth; and

WHEREAS, the full joint subcommittee that was established was able for the most part to complete its work on the interstate banking issue and the revision of the savings and loan laws in order to introduce legislation but needs to continue to monitor federal activity in these areas; and

WHEREAS, the interest rate subcommittee of the full joint subcommittee was diligent in its efforts to complete its work but was unable, due to time constraints, to draft a final bill that it felt was satisfactory and, therefore, needs to continue its study; and

WHEREAS, there remains a need to revise the interest rate laws and to state them in a clear manner for the benefit of the citizens of the Commonwealth; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the joint subcommittee established pursuant to House Joint Resolution No. 30 of the 1984 General Assembly, is requested to continue its study of the interest rate laws of the Commonwealth, in order to clarify and consolidate them and to continue to monitor the federal government's activity in the areas of savings and loan laws and interstate banking.

The membership of the joint subcommittee shall remain the same. In the event a vacancy should occur in the membership, the vacancy shall be filled by the same person or committee as provided in the House Joint Resolution No. 30 of 1984.

All agencies of the Commonwealth shall assist the joint subcommittee in its study.

The joint subcommittee shall complete its work in time to submit recommendations to the 1986 Session of the General Assembly.

All direct and indirect costs of conducting this study are estimated to be $19,000.

Delegate George H. Heilig, Jr., of Norfolk remained the Chairman of the subcommittee. The other members of the House of Delegates appointed under House Joint Resolution No. 30 of the 1984 Session continued to serve under House Joint Resolution No. 217 of 1985 and they were: William T. Wilson, of Covington, Alson H. Smith of Winchester, Franklin P. Hall of Richmond and Vincent F. Callahan, Jr., of McLean. Senator William F. Parkerson, Jr. of Henrico remained the Vice-Chairman of the subcommittee. The other senate members appointed under House Joint Resolution No. 30 of 1984 continued to serve on the joint subcommittee under House Joint Resolution No. 217 and they were: Edward E. Willey of Richmond, Peter K. Babalas of Norfolk and Richard J. Holland of Windsor. The two citizen members who were appointed pursuant to House Joint Resolution No. 30 of the 1984 Session continued to serve under House Joint Resolution No. 217 of 1985 General Assembly and they were John B. Bernhardt, Vice-Chairman of the Board of Sovran Bank and Edwin B. Brooks, President of Virginia Federal Savings and Loan Association.

C. William Cramme', III, Senior Attorney and Terry Mapp Barrett, Research Associate of the Division of Legislative Services served as legal and research staff for the subcommittee. Barbara Hanback and Ann Howard of the House Clerk's office provided administrative and clerical staff assistance for the subcommittee.

WORK OF THE SUBCOMMITTEE

The subcommittee's first meeting held on June 17 was an organizational meeting. Representatives of the various financial institutions had been asked by the Chairman of the subcommittee to update and make comments on the newly enacted savings and loan laws and interstate laws passed by the 1985 General Assembly. The meeting was also held to informally discuss the method by which the subcommittee would study the interest rate laws.

At that meeting the Virginia Bankers Association updated the committee on the interstate banking legislation that was passed in 1985. Representatives of the Association observed that a week prior to the meeting the United States Supreme Court had upheld the principle of regional interstate banking in the case of Northeast Bancorp, Inc., et al v. Board of Governor's of the Federal Reserve System, et al 105 S. Ct. 245(1985). The Association noted that the Supreme Court's decision was a broad decision and stated that the regional interstate banking principle did not violate the Douglas Amendment, the Commerce Clause, the Compact Clause or the Equal Protection Clause, and thereby answered all major constitutional questions as to the principle of regional interstate banking. The Association advised the subcommittee that since the passage of the interstate banking legislation there had been certain activities among the larger banks toward interstate acquisitions. Thirdly, the Association pointed out that the federal courts were beginning to come to grips with the issue of nonbank banks and whether the Federal Reserve Board had power to limit the growth of the nonbank banks. They stated that should the United States Supreme Court rule favorably for nonbank banks it would take congressional action in order to subject them to regulation. Finally, the Association told the subcommittee that some technical amendments would be needed to the interstate banking legislation but that they would wait to offer them at a later meeting in order that federal activity in this area could be monitored and considered.

Representatives from the Virginia League of Savings Institutions told the subcommittee that they had received positive feedback on the 1985 legislation which revised the savings and lown laws in Virginia. They advised the subcommittee that there would be need of some technical amendments to the 1985 Act but that they would offer them at a later meeting.

Representatives from the Virginia Credit Union League advised the subcommittee that the credit union law changes suggested by the subcommittee in its 1985 report and that were enacted into law by the 1985 General Assembly were working well and favorably accepted.

With regard to the interest rate portion of the study, Delegate Heilig stated that he intended to form an interest rate subcommittee composed of members of the full committee which would review and consider throughout the Summer and Fall changes to the interest rate statutes. He stated that he would chair the subcommittee and would expect it to meet four or five times during the interim. In addition to the representatives of the financial institutions, representatives from the Virginia Poverty Law Center, the Charlottesville-Legal Aid Society, the Blue Ridge Legal Services, the Virginia Mortgage Bankers and the newly formed Virginia Mortgage Association offered their assistance to the interest rate subcommittee in its deliberations during the interim. Mr. Will Robertson representing the Virginia Mortgage Association stated that his association is an organization made up of unregulated lenders in order to provide educational information to its members, to promote ethical business practices and to organize a legislative presence to represent the unregulated lenders. He offered to the subcommittee his association's assistance and stated that his association would like to submit draft legislation that would reorganize the interest rate laws in Virginia. He advised the subcommittee that his association had retained the services of the law firm of McGuire, Woods and Battle to prepare the draft and act as their counsel.

After the June 17th meeting, Delegate Heilig appointed members to serve on the interest rate subcommittee. He decided to chair the interest rate subcommittee and appointed the following members to serve with him: Senator William F. Parkerson, Jr., Delegate Franklin P. Hall, Delegate Vincent F. Callahan, Jr., and Senator Richard J. Holland. During the interim that subcommittee met on September 16, October 21, November 18, December 16 and January 8. At all five of those meetings, draft legislation was discussed section by section and many changes were recommended to the drafts. All of those meetings were public hearings and representatives of the following industries and associations offered testimony and assistance to the subcommittee: the Virginia Bankers Association, the Virginia League of Savings Institutions, the Virginia Independent Bankers' Association, the Bureau of Financial Institutions, the Virginia Mortgage Association, the Virginia Mortgage Bankers, the Virginia Poverty Law Center, the Charlottesville-Albemarle Legal Aid Society, Blue Ridge Legal Services, the Virginia Credit Union League, the Virginia Consumer Finance Association, the law firm of Mays, Valentine, Davenport and Moore, the law firm of McGuire, Woods and Battle, the Virginia Retail Merchants Association, Beneficial Management Association, Household International, Virginia Association of Realtors, Virginia Industrial Loan Associations and several businesses and companies representing themselves. Also, several private citizens attended the meetings and offered testimony and advice to the subcommittee. Having heard testimony from all the interested parties, the subcommittee thoroughly discussed and carefully considered which recommendations to make to the 1986 General Assembly. At its January 8th meeting, the Subcommittee announced those recommendations. Some of the recommendations were made with the condition that further testimony should be heard on various items within the particular recommendation.

RECOMMENDATIONS

The subcommittee offers the following recommendations to the General Assembly.

I. THAT THE GENERAL ASSEMBLY SHOULD PASS A BILL TO REVISE THE INTEREST RATE LAWS OF THE COMMONWEALTH. THAT SUCH LEGISLATION SHOULD REORGANIZE AND REARRANGE THE INTEREST RATE STATUTES IN A MORE LOGICAL MANNER. THAT THE BILL SHOULD CONTAIN, AMONG OTHER THINGS, A PROVISION THAT LIMITS TO FIVE (5) THE MAXIMUM NUMBER OF POINTS THAT AN UNREGULATED LENDER MAY CHARGE ON A SUBORDINATE MORTGAGE LOAN IN ADDITION TO THE TWO PERCENT SERVICE CHARGE, THE INTEREST RATE ON THE LOAN AND THE VARIOUS CHARGES FOR UNDERWRITING THE LOAN; A PROVISION TO REQUIRE A PRO RATA REBATE OF POINTS

IF THE LOAN IS PAID OFF DURING THE FIRST FIVE YEARS; AND A PROVISION THAT LIMITS TO 61 MONTHS OR LESS ADD-ON RATES FOR SUCH LOANS. THAT SUCH LEGISLATION SHOULD CONTAIN A PROVISION TO REPEAL THE NULL AND VOID PENALTY FOR SUBORDINATE MORTGAGE LOANS IN EXCESS OF THE INTEREST RATES ALLOWED BY LAW, THAT A NEW PENALTY BE ENACTED FOR SUCH VIOLATION AND THAT THE REPEAL OF THE NULL AND VOID PROVISION SHOULD BE PROSPECTIVE IN NATURE.

II. THAT LEGISLATION SHOULD BE INTRODUCED TO MAKE THOSE NECESSARY TECHNICAL AMENDMENTS TO THE INTERSTATE STATUTES AND THE SAVINGS AND LOAN STATUTES WHICH WILL MAKE THOSE STATUTES MORE WORKABLE.

III. THAT A RESOLUTION BE INTRODUCED AND PASSED BY THE 1986 GENERAL ASSEMBLY TO CONTINUE THIS STUDY FOR ANOTHER YEAR DURING WHICH TIME THE SUBCOMMITTEE WILL: CONTINUE TO MONITOR THE INTERSTATE LAWS AND ACTIVITIES UNDER THOSE LAWS; LOOK AT THE CREDIT CARD SITUATION; CONSIDER VARIOUS REGULATORY SCHEMES FOR UNSUPERVISED SECOND MORTGAGE LENDERS; CONTINUE TO CONSIDER CHANGES AND MONITOR THE INTEREST RATE LAWS; AND STUDY THE ADD-ON INTEREST RATE ISSUE TO DETERMINE WHETHER THEY SHOULD BE PROHIBITED.

REASONS FOR RECOMMENDATIONS

I. THAT THE GENERAL ASSEMBLY SHOULD PASS A BILL TO REVISE THE INTEREST RATE LAWS OF THE COMMONWEALTH. THAT SUCH LEGISLATION SHOULD REORGANIZE AND REARRANGE THE INTEREST RATE STATUTES IN A MORE LOGICAL MANNER. THAT THE BILL SHOULD CONTAIN, AMONG OTHER THINGS, A PROVISION THAT LIMITS TO FIVE (5) THE MAXIMUM NUMBER OF POINTS THAT AN UNREGULATED LENDER MAY CHARGE ON A SUBORDINATE MORTGAGE LOAN IN ADDITION TO THE TWO PERCENT SERVICE CHARGE, THE INTEREST RATE ON THE LOAN AND THE VARIOUS CHARGES FOR UNDERWRITING THE LOAN; A PROVISION TO REQUIRE A PRO RATA REBATE OF POINTS IF THE LOAN IS PAID OFF DURING THE FIRST FIVE YEARS; AND A PROVISION THAT LIMITS TO 61 MONTHS OR LESS ADD-ON RATES FOR SUCH LOANS. THAT SUCH LEGISLATION SHOULD CONTAIN A PROVISION TO REPEAL THE NULL AND VOID PENALTY FOR SUBORDINATE MORTGAGE LOANS IN EXCESS OF THE INTEREST RATES ALLOWED BY LAW, THAT A NEW PENALTY BE ENACTED FOR SUCH VIOLATION AND THAT THE REPEAL OF THE NULL AND VOID PROVISION SHOULD BE PROSPECTIVE IN NATURE.

In making this recommendation, the subcommittee found that there was a need for providing a new order in the organization of the interest rate statutes, and a need to remove archaic language in order to update the statutes and to add provisions new to the interest rate laws. A copy of the draft which represents the recommendations of the subcommittee appears as Appendix 1 to this report and a copy of comparative tables follow the draft and appears as Appendix 2 to this report.

In reorganizing the interest rate statutes, the subcommittee considered the possibility of stating in the positive what the interest rate laws of Virginia are rather than stating a law and then providing numerous exceptions to that law. The subcommittee found out that, presently, each exception to the contract rate of interest carries its own nuances and fees and that it would be very difficult to take all of the exceptions and narrow them down to one specific statute, fitting all of the fees and peculiarities surrounding each exception into one specific section of the law. For this reason the subcommittee decided to maintain the present arrangement of spelling out each exception to the contract rate of interest in a separate statute.

With regard to the legal rate of interest, the contract rate of interest, and the judgement rate of interest, found in Articles 3 and 4 of the Bill, the subcommittee decided to increase the legal or implied rate of interest from 6% to 10%, and to change the contract rate of interest from 8% to 12%. The subcommittee learned that it was best to have a judgement rate of interest higher than the legal or implied rate of interest in order to encourage debtors to make timely payment of their judgements.

The subcommittee heard a fair amount of testimony on those provisions relating to the plea of usury and the penalty incurred for a usurious transaction. Those statutes appear in Article 5 of the bill as recommended by the subcommittee. The subcommittee found that present Code language which establishes a null and void penalty for loans on subordinate mortgages is having a profound effect on loans in the Commonwealth and is putting those loans in question. Testimony revealed that several states have changed their old statutes which, at one time, declared null and void those contracts made at an interest rate higher than the lawful rate allowed for such loans. The subcommittee decided to incorporate in its draft a provision that would repeal current law that declares null and void contracts made in excess of interest rates allowed for unregulated lenders making subordinate mortgages. They decided to replace the null and void penalty with a provision that would allow for the person paying the excessive interest rate to recover the total amount of the interest paid that was in excess of the permitted rate, plus twice the total amount of the interest paid for the last two years from the date of the last payment, plus court costs and attorney's fees. The subcommittee decided to retain the provision that declares any agreement or contract which in effect attempts to waive a borrowers rights as against public policy. The subcommittee was of the opinion that such a revision of the old provision would be a good solution to the problem and would provide the borrower restitution. The subcommittee felt that only providing a penalty or remedy relating to just the interest paid was not entirely enough. They decided that it would be more appropriate to not only have the entire amount of the interest restored to the borrower, but also for him to be paid attorney's fees and a penalty to correct the situation. The subcommittee decided against including any language which would allow the lending institution to voluntarily adjust the contract before any action were filed against it and thereby be relieved of a penalty.

With regard to the exceptions to the contract rate of interest, the subcommittee decided to reorganize the present statute by categorizing those exceptions into four categories: (1) Charges By Depository and Regulated Lenders; (2) Charges by Non-Depository Lenders; (3) Real Estate Loan Transactions; and (4) Commercial Transactions. In addressing the first category of exceptions, the subcommittee found that the present statutes contain "interest rate disclosure languge". The subcommittee also found that this language appeared in many of the sections in the other three categories of exceptions. The subcommittee decided to revise that language and to cite the federal Truth-In-Lending Law, 15 USC 1601 et seq. In arriving at this decision, the subcommittee heard from the Bureau of Financial Institutions and the Virginia Bankers Association. Some felt that the present language was needed and others felt that the federal law covered it. The subcommittee decided that it would be best to revise the language in the Code and cite the federal Truth-In-Lending laws making sure that if complaints or violations were lodged or made there would be some remedy available in the Virginia statutes.

With regard to former §§ 6.1-330.39 and 6.1-330.40 the subcommittee decided to repeal those two sections. § 6.1-330.39 allowed a bank or savings and loan association or other licensed lender to charge up to 5% interest on loans secured by a passbook savings, savings certficate or certifcate of deposit or other evidence of a savings account. The subcommittee found that federal law presently requires a certain percentage to be charged on such loans. They decided that that particular statute tying a lender to a specific maximum did not serve any purpose and therefore decided to eliminate the section. § 6.1-330.40 stated that banks could make agricultural loans at a rate not to exceed 12%. The subcommittee noted that by changing the contract rate of interest from 8% to 12% this statute was no longer needed and was probably impractical.

The only change made in the group of statutes found in Article 6 of the Bill was made to the two statutes relating to charges which banks and savings and loans can collect on installment loans. The subcommittee decided to combine those two statutes into one statute. They learned that with the advent of the most favorite lender statute the loaning practices of the two institutions have become similar.

With regard to those exceptions for charges by non-depository lenders, found in Article 7 of the Bill, the subcommittee decided that those four statutes should remain as they appear under present law.

As to the third category of exceptions which relate to real estate loan transactions, the subcommittee made the same decision with regard to the group of statutes in this category as it did in previous categories concerning the federal disclosure language. Also, the subcommittee decided to not change the provisions dealing with loans secured by first deeds of trust or first mortgages on real estate or the fees and charges in connection with such loans. The subcommittee also decided to retain the statute which speaks to FHA loans and VA loans or those loans insured or guaranteed by similar federal or governmental agencies.

The one provision on which the subcommittee spent most of its time and heard most of the testimony, was that provision dealing with the unsupervised lender making subordinate mortgage loans. After the conclusion of the 1984 study and during the 1985 General Assembly, House Bill No. 1655 was introduced. That bill's purpose was to limit to 8% the total amount of service charge, discount, initial interest, points or charges by any other name that a unsupervised lender may collect on any loan secured by subordinate mortgage, except for the simple annual interest rate permitted by present § 6.1-330.16 and except for those charges permitted under present § 6.1-330.24. The purpose of that bill became the predominant issue to which the subcommittee directed its attention.

The subcommittee heard testimony from representatives of the Virginia Mortgage Association, who advocated in their draft legislation that an unsupervised lender making such loans be allowed to charge and collect ten points over and above the interest rate of the loan and the cost of writing the loan. A copy of that draft appears as Appendix 3 to this report. That association also stated that besides being interested in the points charged on subordinate mortgages by unregulated lenders it also had interest in the null and void penalty for liens arising under the unregulated subordinate mortgage statute, the separation by statute of the relationship of lenders and brokers, and the subject of collecting out-of-pocket expenses on loans to which lenders have committed and are not closed.

Representatives of that association pointed out that the reasons why so many points are charged by the unregulated lender on subordinate mortgage loans are that the unregulated lender not only has to pay the salaries of their employees and of the owner but also for the use of the servicing company, for errors and ommissions insurance, commitment fees, commissions to loan officers, annual commitment fees to warehousing institutions, the cost for unclosed loans, the use of tax services and advertising. They stated that a company that had been in business for a number of years could begin to carry some of its loans in its own portfolio and thereby begin to collect income interest from those loans and thereby reduce the number of points that it charges on its loans. They noted that there are very few companies that are in that position presently. They stated generally that their association believes that its members do provide a valuable service to the people in the Commonwealth who cannot obtain funds in the standard money market. They stated that their association believes that if the points on the subordinate mortgages made by the unsupervised lenders are to be limited by statute, that 10% was a fair number for upfront money. They stated that those ten points included the 2% service charge that is currently collected on such a loan. The Virginia Mortgage Association testified that it was their opinion that if the Legislature were to set a limit lower than ten as the number of points that an unregulated lender could charge on a subordinate mortgage that a number of businesses would go out of business. Representatives stated that in their opinion their association, which currently consists of twenty two members, would be right back before the General Assembly next year asking that their limit be increased to ten. They stated that most of their members sell their loans in the secondary market, although they have a few members who were larger and better capitalized enough to retain in their own portfolio's some of their loans. They testified that if the Legislature was too restrictive on the number of points that could be charged on these loans, the availability of second mortgages for high risk loans may be limited. Currently, they stated, that the average number of points charged by their members, over and above the 2% service charge, was between 12 and 16 points for a transaction where broker fees were included, and between 10 and 13 points when the transaction did not include the brokers fees. The Virginia Mortgage Association pointed out that some second mortgage lenders can make money from the interest coming in from the loan when they are the larger, better capitalized companies who retain their loans in their own portfolio. However, they stated, that the vast majority of the unregulated lenders making second mortgage loans in Virginia are those who sell on the secondary market and have only one chance of making a profit, and that is through the points charged in advance. They added that the new companies coming into business can grow to retain their own loans and thereby decrease their upfront points charged, but early on, most companies can't afford to retain their own loans. They added that the nonsupervised lenders unless they want to go through the very expensive process of public registration and offering cannot go into the market to raise money like the banks and savings and loans can.

On this question of limiting the number of points that an unregulated lender may charge on a subordinate mortgage loan, the subcommittee heard testimony from a number of legal aid services around the Commonwealth, the Bureau of Financial Institutions, and private citizens. The legal aid services associations brought to the attention of the subcommittee many loan transactions which many of their clients had entered into and that exorbidant or excessive points had been charged on these loans. They pointed out that in most instances the borrower is from a low income household and the rate of interest is normally from 16% to 18% and the loan discount points vary from 25 to 40. They pointed out that in some instances the borrower falls behind in his payments and the loan is refinanced with even more points being charged. They stated that when the total amount of the points charged in the two loans is compared to the total amount actually received by the borrower the percentage rises to over 50%. The legal aid associations submitted testimony to the subcommittee which appears as Appendix 4 to this report. The legal aid associations emphasized that this issue before the subcommittee ought to be dealt with in order to protect the consumer and that a limit on the number of points should be placed by statute. They sussgested that the limit should be no greater than 5 points.

One of the citizens to address the subcommittee was Mr. Dwain Wise who is a retired mortgage executive. He pointed out to the subcommittee that he was representing no one but himself and had been in the mortgage business for several years prior to his retirement. Mr. Wise submitted testimony to the subcommittee which appears as Appendix 5 to this report. Also in Appendix 5 are responses to his written testimony from the Virginia Mortgage Association and from the law firm of Mays, Valentine, Davenport and Moore which were requested by the subcommittee. Mr. Wise stated that his basic concern was in a situation where a consumer sees advertisements in the telephone book or newspaper regarding second mortgage lenders and does not know the difference between the types of lenders making second mortgage loans in Virginia. He stated that he recommended a limit of 5 points be placed on subordinate mortgages made by the unsupervised lender. He also recommended that if such a loan should be paid off within five years that there be a pro-rata rebate of those points. He also stated that in his years of work with the mortgage companies, he found out that in Maryland and North Carolina, where there are such caps placed on the number of points allowed, that there was no shortgage of lenders and there was no shortgage of Fannie Mae loans or buyers of loans in the secondary market.

With regard to the issue of points, the Commissioner of the Bureau of Financial Institutions stated that there were costs involved in doing any kind of business. He stated that it seems to be a usual business practice to set prices high enough in order to provide for the paying of the cost of doing business plus to provide for a profit. He stated that he sees nothing that would warrant such exempting of second mortgage businesses from this law of business. He emphasized that he saw no reason why a lender could not recover the cost of doing business plus a fair return through the rate of interest that it charges for making the loan. He remarked that he had no problem with allowing second mortgage lenders to set their interest rates in order to recover their costs, but he advised that to say that those types of lenders are special and need a fixed rate is allowing for a subsidy in his opinion. He remarked that to allow second mortgage lenders to lend at a certain interest rate plus at a certain number of points is cost-plus lending. The Commissioner suggested to the subcommittee that if it wants to lower points on subordinate mortgages offered by second mortgage lenders, that the subcommittee may want to apply the limit to the class of transaction and not to the class of people. He stated that the same rules should apply to second mortgage liens regardless of who makes the loan. The Commissioner observed that the unregulated lenders do serve a different market from the banks and savings and loan associations and their sources of funds are different. He noted that the banks and savings and loans do buy funds at market rates, and the market rate of banks and savings and loans is less than the rates charged the unregulated lender. However, he also stated, that the argument that the unregulated lender has to charge points in order to get their loans into the secondary market is an issue that he does not understand. He suggested that they charge adjustable rates on their loans in order to accomplish the same purpose. He stated that he did not see the distinction between charging points and interest or charging at a rate of interest in order to recoup costs and make a fair profit. He stated that in his opinion there was no difference in making a loan for 18% interest and one for 12% interest plus 6 points. He reitterated that setting the interest rate high enough to sell it in the secondary market and to not charge points should be the way to do business in this area and that competition would take its course. A copy of written remarks concerning the entire study presented to the subcommittee by the Commissioner appears as Appendix 6 to this report.

A second area of concern that the Virginia Mortgage Association stated that they had in the interest statutes was that of the relationship between the lender and the broker and how fees were paid to the broker in the loan transaction. Representatives of the Mortgage Association stated that the broker strikes an independent contractual relationship with the borrower. They stated that it is the job of the broker to assist the customer to obtain a suitable loan from a lender. They stated that normally the unregulated lender pays the broker his fee from the money collected at the closing. They emphasized that their association feels that their members should not be saddled with the collection of brokerage charges and paying them. They also emphasized that the reason they were suggesting that a statutory change be made to regulate this relationship is that the contractual relationship between the broker and the borrower cannot be affected by the lender, and that that relationship is an independent one between the broker and borrower. They stated that they have know way to control that arrangement. The association also advised the subcommittee that the percentage of loans referred to unregulated lenders by brokers varies from company to company, and that it can be anywhere from 0% to 100%.

Various mortgage brokers from around the Commonwealth testified that although they deal with many lenders in the Commonwealth, as brokers they did not want to be directly associated or tied to any one lender. They stated that they like to shop around among lenders in order to get the best rate for their client. They stated that a typical situation is where a borrower has been to lenders and cannot get a loan that they feel comfortable with and therefore seek the professional help of a broker. They stated that most of their business is excellent credit business but the borrower simply cannot get the rate that they want. They pointed out that if the lender is restricted to certain limitations on the points that they charge, that in many cases they would not be able to make loans to the borrowers. They stated that if the brokers remain tied to the lenders the borrower will end up getting higher rates. They maintained that the relationship that they have with the borrower is an independent relationship and is not tied with the lender. They affirmed that they do not charge unless the loan is obtained. Although the brokers were unable to state what an average fee would be for their services because of the fact that each loan is different, one broker did say that he would normally charge 8 points on a $10,000 loan. Testimony revealed that if the law set a limit on the number of points a lender could collect on such loans, the lender would charge and collect all of those points. The subcommittee found that if the brokers were to charge points for doing business, those points would be over and above what the lender would collect. Representatives from both the brokerage business and the Virginia Mortgage Association pointed out that in many instances the lender may reduce the number of points that they collect in order to keep the broker's business coming into their company. They both agreed that lenders normally know what the brokerage charges are before there is ever a commitment on a loan.

Representatives from legal aid services pointed out that if the subcommittee were to take the Virginia Mortgage Association's recommendation to separate the relationship between lenders and brokers, the subcommittee could in effect be raising the number of points charged on subordinate mortgage loans. They suggested that the subcommittee may want to see what other states are doing with regard to limiting the charging of points and then compare what those states are doing as far as regulating the relationship between the brokers and unregulated lenders. They testified that in a situation where a person goes to a broker to obtain a loan and the broker goes to a subordinate mortgage lender, the borrower is actually paying points plus points.

The Commissioner of the Bureau of Financial Institutions stated that it was a fiction that an unregulated lender did not know of the arrangements between the borrower and broker because the broker and the lender have arrangements on how to divide the points collected. The Commissioner suggested that in the interest of competition the activities of brokers and the payment for their services should be strickly and absolutely confined to separate, private arrangements between such brokers and prospective borrowers, with lenders prohibited from passing the cost of such services to the borrowers.

The third area of interest to which the Virginia Mortgage Association stated a concern, was that of the null and void penalty section. They stated that although the subcommittee had decided to repeal the present null and void penalty section and replace it with provisions that would provide the borrower restitution, they suggested that the subcommittee might reconsider their decision and leave it to the courts to decide whether the section is remedial in nature or substantive in nature. They stated that the insurers of the mortgages that may be affected by the null and void penalty were behind the repealing of the null and void penalty section and the redrawing of the provision because they felt exposure from the Landbank situation in Virginia. The Mortgage Association questioned the reasons for repealing the penalty section and stated that the insurers have struck a contract and that they should live by it. They stated that there is a constitutional question surrounding the null and void penalty section and that if the penalty were left on the books then it could be subject to constitutional challenge to decide whether it operated retroactively or not. The subcommittee heard testimony from representatives of an insurance company who had insured unregulated lenders' on loans and they requested that language be put into the draft to provide that the repeal of the null and void penalty section would have prospective affect only. See Appendix 7 of this report for the insurers written testimony. The subcommittee decided to put that language into the draft.

With regard to the Virginia Mortgate Association's fourth concern, that being the collection of out-of-pocket expenses for unclosed loans to which a commitment had been made, they stated that their members would like to have the authority to recover out-of-pocket expenses on those transactions in an amount greater than the statutes allows presently. They stated that presently the statute limits them to collecting $50 for such unclosed loans, and that they would like to see that figure raised to $250. They stated that typically appraisals and credit reports amount to much more than $50. They also advised the subcommittee that 50% of the loans to which they commit are never closed. The Commissioner of Financial Institutions stated that he had no objection to allowing the lender to recover costs when the loan fell through if the lender committed in writing to the borrower and the borrower had caused the lender to incur costs. He cautioned the subcommittee that the committment should be in writing. He testified that the Bureau of Financial Institutions is aware of attempts to recover costs when no committment was in writing and no costs were incurred. The subcommittee decided to leave the dollar amount for such costs as it presently appears in the Code.

Concerning the pro-rata rebate suggestion offered by Mr. Wise in his remarks to the subcommittee, the subcommittee decided to draw into the new statutes a provision which would require the unregulated lender making subordinate mortgage loans to rebate on a pro-rata basis points to the borrower when the borrower repays such a loan within five years. The Virginia Mortgage Association testified that such a provision was objectionable to them since it would make it very difficult for them to sell their loans in the secondary market with a provision such as this following the loan document. Representatives from the legal aid services associations stated that they were in favor of this recommendation, because they were of the opinion that such a provision would eliminate the gouging of the consumer.

The subcommittee elicited testimony on the issue of whether add-on loans should be limited to a certain number of years or whether they should be prohibited all together. One suggestion given to the subcommittee was to limit the use of the add-on rate for terms in excess of five years because the earnings over a longer period are greatly distorted to the detriment of the borrower who prepays the loan for any reason. Some testified that most of these loans are paid early, usually by the end of the fourth year. The Commissioner of Financial Institutions testified that the result of loans made under the present authority given to unregulated lenders to charge add-on rates for subordinate mortgages is unconscionable. He stated that in his opinion add-on rate interest should not be permitted on any loan secured by the borrower's residence. He stated that if the rate of interest is stated in simple interest terms, the borrower has a clearer, more understandable basis for deciding whether to accept the terms offered. He pointed out that if the add-on interest rate is to continue to be permitted to these lenders, the definition of the term "charge in advance" should remain in the law. Representatives of the Virginia Mortgage Association stated that many of their members are not using add-on rate structures. They stated that some members feel that add-on rates are the only way to go when they are making high risk loans. They stated that as to the suggestion of eliminating the authority to make add-on loans and going to a simple interest rate structure, they suggested that that elimination be across the board for all lenders. The subcommittee decided to place a sixty-one month limit for loans bearing an add-on interest rate structure.

A final suggestion that the subcommittee addressed regarding the category of real estate loan transactions as exceptions to the contract rate of interest, was that of some form of a regulatory scheme of the unregulated lender. The subcommittee heard a suggestion that would require the unregulated lender to register with the Bureau of Financial Institutions. Registration could entail the listing of the names and current addresses of the corporation and of the officers of the corporation, similar to what would be found in corporate records. The Virginia Mortgage Assocation stated that their reaction to such a registration would be seen as a favorable solution in handling complaints and that they would be a willing participant in this registration scheme. The subcommittee found that the only remedy that current law offers a borrower when he has a complaint against an unregulated lender is through a court proceeding such as a declaratory judgment or by stopping payment on the loan and forcing the lender to seek foreclosure whereupon the borrower could seek to enjoin the foreclosure. The association went on record as saying that they like the registration proposal because it would allow the consumer to have somewhere to turn when they had a complaint. They offered as a further suggestion that complaints could be handled by requiring the second mortgage lender to give to the borrower, at the time the loan was closed, an information sheet which contained the number of the Bureau of Financial Institutions and other information in order to allow the borrower to complain should an abuse occur. The Commissioner of Financial Institutions cautioned the subcommittee in adopting such a registration scheme, not only from the point that it would have a budgetary impact but also it could cause confusion in the public. He stated that the public could confuse regulation with registration. He stated that registration involves no enforcement. He emphasized that the Legislature will want to take care that the public realizes that financial institutions such as, banks, savings and loan associations, industrial loan associations, and consumer finance companies are regulated businesses, and that registration of unregulated lenders would not include enforcement provisions and rights such as the borrowers presently have against those institutions. The subcommittee also heard testimony that fees could be charged for such registration in order to defray the cost of the State Corporation Commission expenses.

The subcommittee decided to make very few changes to the provisions of those statutes found in the fourth and last category of exceptions to the contract rate of interest, relating to commercial transactions. They are included in Article 9 of the Bill. The subcommittee decided to divide into two sections the present Code section which disallows the defense of usury for loans over $5,000. The subcommittee found the need to set out in one statute, provisions for loans for $5,000 or more made by financial institutions, and to set out in a separate statute provisions for loans made for $5,000 or more made for business purposes.

In consideration of the last group of sections in the subcommittee's draft bill, relating to late charges, prepayment and excelleration laws and the borrowers rights, the subcommittee, in general, made very few changes to present law. The subcommittee decided to amend the present law to require unregulated lenders making first deed of trust loans to permit prepayment without a penalty when the loan is for $75,000 or less. The subcommittee found this to be equitable so that both regulated and unregulated lenders making these types of loans would be covered. Testimony indicated that second deed of trust loans would be covered by another section in the bill.

The subcommittee heard much testimony on the fact that industrial loan associations not only have a right to compute unearned interest in accordance with the Rule of 78's but also may charge a prepayment penalty not to exceed 2% of the amount of the prepayment. It was noted that industrial loan assocaitions are the only types of lenders that are able to have the benefit of both of these. The subcommittee found that unregulated lenders who make subordinate mortgage loans calculate the rebate of interest under the Rule of 78's but are not entitled to any prepayment penalty, and lenders who make first mortgage loans are entitled to a prepayment penalty but nothing else. The subcommittee heard testimony to the effect that loans made by the unregulated lenders are as high a class of risk as those made by industrial loan associations. The industrial loan associations stated that the reason for the 2% prepayment penalty is to help them defray the cost of loans made by them that are, in turn, refinanced by other lenders. The industrial loan associations stated that they knew of no abuses on the prepayment penalty and that it is more of an exception than a rule. They emphasized that there is no penalty if the customer refinances with the same lender. The Commissioner of Financial Institutions pointed out that if the prepayment penalty is an element of risk then that is a function of interest and that he would see no problem in removing the provision. He disagreed with the philosophy of allowing one lender to charge a prepayment penalty and not allowing another to do so. The industrial loan associations pointed out that if the subcommittee were to recommend a repeal of the prepayment penalty it would increase upfront costs to all borrowers of industrial loan associations and not just to those who cause the cost to be incurred.

Having considered the substantive provisions of the interest rate laws, the subcommittee addressed the need of definitions having chapter wide application. The discussion centered around the question of whether the definition of the terms "bank", "credit union", and "savings and loan association", should apply to financial institutions in Virginia as well as apply to out of state financial institutions incorporated in other states. Appendix 8 to this report contains in written form much of the testimony heard by the subcommitee on this subject. The question was whether this category of financial institutions should have the benefits of Virginia law by utilizing one of the no-limit statutes for the purpose of charging interest in Virginia when such institutions are not regulated by Virginia. The subcommittee decided to include within the definition of "bank", "credit union", and "savings and loan association" reference to out-of-state financial institutions. Such reference would give nationwide effect to the interest rate statutes. The subcommittee noted, however, that these definitions would be subject to further discussions and review by committees of the General Assembly.

For the reasons cited above, the subcommittee recommends that a revision of the interest rate laws be passed by the 1986 General Assembly.

II. THAT LEGISLATION SHOULD BE INTRODUCED TO MAKE THOSE NECESSARY TECHNICAL AMENDMENTS TO THE INTERSTATE STATUTES AND THE SAVINGS AND LOAN STATUTES WHICH WILL MAKE THOSE STATUTES MORE WORKABLE.

The subcommittee received written testimony from Virginia League of Savings Institutions concerning those technical amendments necessary to the Virginia savings and loan laws. This testimony is found in Appendix 9 to this report. For the reasons stated in that written testimony the subcommitte recommends that legislation be passed by the 1986 General Assembly to make such technical and curative amendments.

III. THAT A RESOLUTION BE INTRODUCED AND PASSED BY THE 1986 GENERAL ASSEMBLY TO CONTINUE THIS STUDY FOR ANOTHER YEAR DURING WHICH TIME THE SUBCOMMITTEE WILL: CONTINUE TO MONITOR THE INTERSTATE LAWS AND ACTIVITIES UNDER THOSE LAWS; LOOK AT THE CREDIT CARD SITUATION; CONSIDER VARIOUS REGULATORY SCHEMES FOR UNSUPERVISED SECOND MORTGAGE LENDERS; CONTINUE TO CONSIDER CHANGES AND MONITOR THE INTEREST RATE LAWS; AND STUDY THE ADD-ON INTEREST RATE ISSUE TO DETERMINE WHETHER THEY SHOULD BE PROHIBITED.

Due to the large amount of time spent on the unregulated lender issue, the subcommittee found that it was unable to thoroughly consider several important aspects of the interest rate laws some of which were new suggestions and brought to its attention throughout the interim. The subcommittee heard testimony at its November meeting on a study done by the Tayloe Murphy Institute on credit cards but was unable to analyze that institution's conclusions. The subcommittee also heard testimony on various other issues raised by the participants in the study but due to time constraints were unable to carefully consider the suggestions and issues. For this reason the subcommittee recommends that a resolution continuing the study for another year be introduced and passed by the 1986 General Assembly. The subcommittee recommends that that resolution ask that the subcommittee continue to monitor the interstate laws, to look into the credit card situation, to consider some sort of regulatory scheme for the unsupervised lender, to monitor the effects of and to continue to work on the interest rate draft and to study the add-on loan situation to determine whether add-on loans should be authorized or abolished. A copy of that resolution is attached as Appendix 10 to this report.

CONCLUSION

The subcommittee expresses its appreciation to all parties who participated in its study. The subcommittee expresses its desire that all parties who participated will continue to participate in its future study of the issue. The subcommittee's recommendations have been offered only after carefully and thoroughly studying the data that was received. The subcommittee believes its recommendations are in the best interest of the Commonwealth and encourages the General Assembly to adopt those recommendations.

Respectfully submitted,

George H. Heilig, Jr., Chairman

William F. Parkerson, Vice-Chairman

William T. Wilson

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APPENDICES

1. Bill Draft.
2. Tables.
3. Virginia Mortgage Association Draft.
4. Legal Aid Services Testimony.
5. Wise Letter and Responses.
6. Commissioner of Financial Institutions Testimony.
7. Mays, Valentine's, Insurance Letter.
8. Definitions Correspondence.
9. Virginia League of Savings Institutions Memo.
10. Resolution to Continue Study.

APPENDIX 1

HOUSE BILL NO. 400

A BILL to amend the Code of Virginia by adding in Title 6.1 a Chapter numbered 7.3, containing Articles numbered 1 through 10 and sections numbered 6.1-330.49 through 6.1-330.90, and to repeal Chapter 7.2 of Title 6.1 of the Code of Virginia, containing Articles numbered 1 through 10 and sections numbered 6.1-330.6 through 6.1-330.48, so as to revise, rearrange and amend the laws of Virginia relating to money and interest generally; penalties.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Title 6.1 a Chapter numbered 7.3, containing Articles numbered 1 through 10 and sections numbered 6.1-330.49 through 6.1-330.90, as follows:

CHAPTER 7.3.

MONEY AND INTEREST.

Article 1.

Definitions.

§ 6.1-330.49. Definitions.– As used in this chapter, unless the context provides otherwise:

"Bank" shall mean any national bank, a bank organized under Chapter 2 (6.1-3 et seq.) of this title or banks incorporated and organized under the laws of another state.

"Credit union" shall mean a credit union organized under Chapter 4 (§ 6.1-196 et seq.) of this title or credit unions incorporated and organized under the laws of another state. "Credit union" shall not include within its meaning federal credit unions.

"Entity" shall mean any association, corporation, partnership, firm, company, trust, estate or business trust.

"Person" shall include an individual and an entity.

"Savings and loan association" shall mean any federal savings and loan association, a savings and loan association organized under Chapter 3.01 (§ 6.1-194.1 et seq.) of this title or savings and loan associations incorporated and organized under the laws of another state.

Article 2.

Money of Accounts.

§ 6.1-330.50. Money of account.–The money of account of this Commonwealth shall be the dollar, cent and mill. All accounts by public officers shall be so kept. No writing shall be invalid, nor the force of any account or entry be impaired, because a sum of money is expressed otherwise.

§ 6.1-330.51. Ascertaining value in money of account for money expressed in foreign currency.– In any suit for a sum of money expressed in any foreign currency or otherwise than in the money of account of this Commonwealth, the jury or the court shall ascertain the value in the money of account of the sum so expressed, making allowance for the difference of

exchange as shall be just. The judgment or order may be for either the amount so ascertained, or for the amount of money so expressed which shall be discharged by an amount so ascertained. As to any such suit involving an instrument to which § 8.3-107 is applicable, the provisions of that section shall apply.

§ 6.1-330.52. Issuance of currency; contracts and securities obtained by illegal currency; capital stock of certain companies, etc., vested in State; proceedings to recover such stock; liability.– A. 1. No entity unless authorized by law shall:

a. Issue, with intent that the same be circulated as currency, any note, bill, scrip, or other paper or thing, or

b. Otherwise deal, trade or carry on business as a bank of circulation.

2. All contracts made for forming any such entity as described in paragraph 1 of this subsection shall be void.

B. All contracts and securities that may originate from, or be made or obtained in whole or in part by means of any illegal currency dealing, trade or business, shall be void. If any person shall pay any money or other valuable thing on account of any such contract or security, such person or his or its representative, or assignee, may, by suit brought within one year after such payment, recover back the amount or value of such payment from the person or such representative to whom, or to whose use, it may have been made.

C. The capital stock of every such entity, whether paid up or merely subscribed, shall belong to the Commonwealth. The Attorney General, whenever informed of the existence of any such entity, shall institute a suit in the Circuit Court of the City of Richmond, for the purpose of recovering such capital stock. In such suit, all or any of the members of such entity, and any of its officers, agents, or managers, may be made defendants, and compelled to exhibit all their books and papers, and an account of everything necessary to enable the court to enter a proper order. But no disclosure made by a defendant in such suit, and no book or paper exhibited by him in answer to the bill, or under the order of the court, shall be used as evidence against him in any case at law.

D. Every member of any such entity, made defendant in any such suit, shall be held liable to the Commonwealth for his proportion of the capital stock in such entity held by him, or for his use or benefit, at the institution of such suit, or at the time of the order. Such order against any defendant shall be a bar to a proceeding against him for any act done in violation of subsection A of this section.

Article 3.

Legal and Judgement Rates of Interest.

§ 6.1-330.53. Legal rate of interest; when legal rate implied.– The legal rate of interest shall be an annual rate of ten percent. Except as provided in §§ 8.3-118 (d) and 6.1-330.54, the legal rate of interest shall be implied where there is an obligation to pay interest and no express contract to pay interest at a specified rate.

§ 6.1-330.54. Judgment rate of interest.– The judgment rate of interest shall be an annual rate of twelve percent, except that a money judgment entered in an action arising from a contract for the loan of money shall carry interest at the rate lawfully charged on such contract, or at twelve percent annually, whichever is higher.

Article 4.

Contract Rate of Interest.

§ 6.1-330.55. Contracts for more than legal rate of interest.–Except as otherwise permitted by law, no contract in writing shall be made, for the loan or forbearance of money, at a greater annual rate of interest than twelve percent.

For contracts which may be made at an annual rate of interest greater than twelve percent, reference is hereby made to Article 6 (§ 6.1-330.59 et seq.) of this chapter. Further reference is hereby made to Chapter 6, §§ 6.1-244 to 6.1-310, relating to powers of consumer finance companies.

Article 5.

Usury; Penalty.

§ 6.1-330.56. Plea of usury; evidence; judgment.– Any borrower may plead in general terms that the contract or assurance on which the action is brought was for the payment of interest at a greater rate than is allowed by law. Once the court has determined that the rate is usurious, judgment shall be rendered only for the principal sum.

§ 6.1-330.57. Recovery of twice total usurious interest paid; limitation of action; injunction to prevent sale of property pending action.–A.1. If interest in excess of the rate of interest permitted by the applicable statute shall be paid in any case for the loan or forbearance of money, the person paying may, in a suit or action brought within two years from the date of the last payment, recover from the person taking or receiving such payments:

a. The total amount of the interest paid that is in excess of the permitted rate;

b. Twice the total amount of interest paid for the last two years from the date of the last payment; and

c. Court costs and attorneys' fees .

2. If property has been conveyed to secure the payment of the debt and a sale thereof is about to be made, or is apprehended, an injunction may be awarded to prevent such sale pending the suit or action.

§ 6.1-330.58. Contracts, etc., in violation of public policy. Any agreement or contract in which the borrower waives the benefits of this chapter or releases any rights he may have acquired by the virtue of this chapter shall be deemed to be against public policy and void.

Article 6.

Exceptions to Contract Rate of Interest;

Charges by Depository and Regulated Lenders.

§ 6.1-330.59. Charges by banks.–Notwithstanding any statute or provision relating to interest or usury, loans made by banks or by a savings and loan association payable in weekly, monthly or other periodic installments may be lawfully enforced as agreed in the obligation of indebtedness or at the interest rate stated therein on the principal amount loaned or forborne or contracted to be lent or forborne. Notwithstanding the foregoing, a service charge not exceeding two percent of the amount of the loan may also be imposed. When a loan is made under authority of this section, disclosure of charges shall be given as required by the federal Truth-in-Lending Law, 15 USC 1601, and regulations adopted pursuant thereto. This section shall not be construed to impose any disclosure requirement beyond that of federal law and those regulations. An interest rate charged in advance upon the entire amount of the loan or pursuant to a written agreement of modification shall be an "interest rate stated therein."

§ 6.1-330.60. Defense of usury not applicable to certain loans.– No person shall, by way of defense or otherwise, avail himself of the provisions of this chapter or any other section relating to usury to avoid or defeat the payment of interest, or any other sum, when such loan is made to a person by a financial institution as defined in § 6.1-2.1, provided the initial amount of the loan is $5,000 or more.

§ 6.1-330.61. Loans of up to one year.–Any bank, or any broker duly licensed to transact business as a stockbroker or as a broker dealing in options and futures under the provisions of Title 58.1, may loan money or discount bonds, bills, notes or other paper for periods of up to one year, and such loan or discounting may be lawfully enforced as agreed in the obligation of indebtedness or at the interest rate stated therein on the principal amount loaned, forborne or discounted or contracted to be lent, forborne or discounted. An interest rate charged in advance upon the entire amount of the loan or discount shall be an "interest rate stated therein."

§ 6.1-330.62. Charges by banks.– A. 1. Any bank may charge a rate as agreed between it and the borrower under a contract for revolving credit or any plan which permits an obligor to avail himself of the credit so established. Any charge computed on the basis of a rate shall be charged at the option of the bank on either:

a. The average daily balance for the period ending on the billing date;

b. The balance existing on the billing date of the month; or

c. Any other balance which does not result in the seller or lender charging and receiving any sum in excess of what would be charged and received in a. or b. of this paragraph.

2. No service charge shall be charged unless the bill is mailed not later than eight days (excluding Saturdays, Sundays and holidays) after the billing date, except that such time limitation shall not apply in any case where the seller or lender has been prevented, delayed, or hindered in mailing or delivering the bill within such time period because of an act of God, war, civil disorder, natural disaster, strike, or other excusable or justifiable cause.

3. In the event of the extension of credit by a bank hereunder to be effected by the use of a credit card for the purchase of merchandise or services, no charge shall be imposed upon the cardholder or borrower on such extension if payment in full of the unpaid balance owing for extensions of credit for merchandise or services is received at the place designated by the creditor prior to the next billing date, which shall be at least twenty-five days later than the prior billing date.

B. The higher rate in excess of charges permitted prior to July 1, 1982, shall not take effect as to balances existing on or before April 1, 1983, unless:

1. Such creditor shall notify the borrower in writing of the proposed change, that acceptance of the higher charge on existing balances and balances incurred prior to the effective date of the change is accepted by use of the revolving credit after the giving of the notice, and such borrower is given at least nine months prior to the effective date of such change to pay off balances existing on the date of such notice, and

2. Such borrower accepts the proposed change and modification of interest rates by using the revolving credit at any time thirty days or more after the giving by the creditor of the notice.

§ 6.1-330.63. Credit union loans.– A. A credit union may make loans to its members, and to other credit unions doing business in Virginia, at rates of interest not exceeding one and one-half percent per month, computed on unpaid balances.

B. Notwithstanding the provisions of subsection A of this section, or any other statute or provision relating to interest or usury, loans made by credit unions payable in weekly, monthly, or other periodic installments may be lawfully enforced at the interest rate stated in the obligation of indebtedness, or in any written modification or amendment thereof, computed on unpaid balances of the principal amount loaned.

Article 7.

Exceptions to Contract Rate of Interest;

Charges by Non-Depository Lenders.

§ 6.1-330.64. Extension of credit under Securities and Exchange Act.–A broker-dealer licensed by the State Corporation Commission and registered with the Securities and Exchange Commission who extends credit to a customer on pledged securities as permitted under the provisions of the Securities and Exchange Act of 1934, may charge the customer on his debit balances that are payable on demand such rate of interest as may be mutually agreed on. Such rate shall not exceed a monthly charge at an annual rate of one and three-quarters percent of the debit balances above the higher of:

1. The interest rate charged such broker-dealer by a bank doing business in this Commonwealth on loans collateralized by securities or

2. The interest rate charged such broker-dealer by a bank doing business in this Commonwealth on loans for business purposes.

§ 6.1-330.65. Charges by private colleges and universities.–Loans made by a private college or university in Virginia to its students, parents or guardians for educational expenses, including but not limited to tuition, fees, books, supplies, room, board and personal expenses, may be lawfully enforced as agreed in the obligation of indebtedness or at the interest rate stated therein on the principal amount loaned or forborne or contracted to be lent or forborne. For purposes of this section, the term "private college or university" shall mean a private, accredited and nonprofit institution of collegiate education in the Commonwealth whose primary purpose is to provide collegiate or graduate education.

§ 6.1-330.66. Loans by pension plans to participants.–Loans by a pension plan to an individual participating in such pension plan, including an "employee pension benefit plan" or "pension plan" as defined in § 3 (2) of the Employee Retirement Income Security Act of 1974, are not subject to the provisions of this chapter. No such participating individual shall, by way of defense or otherwise, avail himself of the provisions of this chapter, or any other section relating to usury, to avoid or defeat the payment of interest or any other sum on any loan or extension of credit by such pension plan. Nothing contained in any of such sections shall be construed to prevent the recovery of such interest or other sum though it be more than otherwise lawful interest and though that fact appears on the face of the contract.

§ 6.1-330.67. Charges by industrial loan associations.–A. Notwithstanding any statute or provision relating to interest or usury, loans made by industrial loan associations payable in weekly, monthly or other periodic installments may be lawfully enforced as agreed in the obligation of indebtedness or at the interest rate stated therein on the principal amount loaned or foreborne or contracted to be lent or foreborne. Notwithstanding the foregoing, a service charge not exceeding two percent of the amount of the loan may also be imposed. An interest rate charged in advance upon the entire amount of the loan or pursuant to a written agreement of modification shall be an "interest rate stated therein."

B. An industrial loan association may charge an annual interest rate of eighteen percent on loans payable on demand or in a single payment. Such association may impose on such a loan the same service charge allowed by subsection A of this section.

ARTICLE 8.

Exceptions to Contract Rate of Interest;

Real Estate Loan Transactions.

§ 6.1-330.68. Certain contracts enforced at rate of interest stated therein; definition of terms for this section and §§ 6.1-330.80 and 6.1-330.70.–A. Notwithstanding the provisions of §§ 6.1-330.53, 6.1-330.55 and 6.1-330.61 or any other provision relating to interest or usury, contracts made for the loan or forbearance of money, secured or to be secured by a first deed of trust or first mortgage on real estate, or by a first priority security interest in the stock of a residential cooperative housing corporation, may be lawfully enforced as agreed in the obligation of indebtedness or in an agreement signed by the borrower or at the interest rate stated therein on the principal amount loaned or forborne or contracted to be lent or forborne.

B. For the purpose of this section and §§ 6.1-330.70 and 6.1-330.80:

1. Real estate shall be deemed to include a leasehold estate of not less than twenty-five years.

2. An interest rate which varies in accordance with any exterior standard, or which cannot be ascertained from the contract without reference to any exterior circumstances or documents, shall be enforceable as agreed in the obligation of indebtedness or other signed agreement.

3. The terms "first deed of trust" or "first mortgage" shall include all deeds of trust and mortgages, and amendments thereto, which are made by the same grantor or mortgagor, secure notes held by the same holder, convey substantially the same real estate, and are superior to all other deeds of trust or mortgages on the real estate.

4. The terms "grantor" or "mortgagor" shall include an owner of the real estate, and spouse, who has assumed such responsibility for the obligation on such deed of trust or mortgage.

C. Interest which is charged pursuant to a written agreement, whether or not recorded, shall be of equal priority with the principal debt secured by the mortgage or deed of trust and shall have priority as to third parties as provided in Title 55.

D. Notwithstanding any other statute or rule of case law relating to compounding of interest, if regularly scheduled periodic payments on an obligation secured by a first mortgage or first deed of trust on real estate are insufficient to pay currently accruing interest on the then principal balance, an agreement in the obligation of indebtedness, or other agreement signed by the borrower, secured thereby, providing for the addition of such unpaid interest to the principal balance and the future accrual of interest on such balances, shall be enforceable as written.

§ 6.1-330.69. Fees and charges in connection with loans by real estate lenders; certain borrowers not to be required to employ particular attorney, surveyor or insurer.–A. A lender engaged in making real estate mortgage or deed of trust loans may charge and collect in advance from the borrower a service charge as agreed between the parties not to exceed the amount permitted by § 6.1-330.68. Such a lender also may require the borrower to pay the reasonable and necessary charges in connection with making the loan, including the cost of title examination, title insurance, recording and filing fees, taxes, insurance, including mortgage guaranty insurance, appraisals, credit reports, surveys, drawing of papers and closing the loan.

B. In the case of loans on one to four family residences, the lender may not require the borrower to use the services of a particular attorney, surveyor or insurer. However, the lender shall have the right to approve any attorney, surveyor, or insurer selected by the borrower, provided such approval is not unreasonably withheld.

C. Any lender in compliance with the Federal Insurance Regulations of the Federal Home Loan Bank Board relating to loan services and fees as in effect on July 1, 1977, shall be deemed to be in compliance with this section.

D. Such fees and charges shall not be considered in determining whether a contract for a loan or forbearance of money or other things is illegal within the meaning of this title.

§ 6.1-330.70. Charges by other than supervised licensed lenders.–A. 1. Any person, other than lenders licensed by and under the supervision of the State Corporation Commission or the federal government or otherwise enumerated in § 6.1-330.73, may charge at an annual interest rate of eighteen percent if such loan is secured in whole or in part by a subordinate mortgage

or deed of trust on residential real estate improved by the construction thereon of housing consisting of four or less family dwelling units. For the purposes of this chapter relating to money and interest, a subordinate mortgage or deed of trust is one subject to a prior mortgage or deed of trust in existence at the time of the making of the loan secured by such subordinate mortgage. An add-on interest loan made under this subsection shall not exceed a period of sixty-one months.

2. The lender may also impose a service charge not exceeding two percent of the amount of the loan, provided that such service charge shall not be made more often than once each eighteen months except to the extent that new money is advanced within such eighteen-month period by a renewal or additional loan. New money shall be money lent in addition to the outstanding principal balance at the time such new advance is made. These provisions shall apply whether payable directly to the lender or to a third party in connection with such loan.

B. No charge, other than actual costs documented to the applicant and expended for a credit report and an appraisal of the real estate conducted in connection with the loan application, may be made if the loan is not made. Such charge shall not exceed one percent of the amount of the loan applied for. However, in no event shall such charge exceed fifty dollars or one-half of such costs, whichever is less. Such charge may be made only if the lender commits to make the loan. Such commitment shall be in writing and signed by the lender or a person the lender has authorized to execute such documents.

C. The provisions of this section shall not apply to any loan by any lender enumerated in § 6.1-330.73.

D. Any loan secured by a subordinate mortgage or deed of trust on such residential real estate with an initial maturity in excess of ten years and two months may be lawfully enforced at the interest rate stated therein on the principal amount of the loan forborne or contracted to be lent or forborne. Notwithstanding the foregoing, a service charge not exceeding two percent of the amount of the loan may also be imposed. Disclosure of charges, not otherwise specified in the note, deed of trust, or mortgage, in an interest disclosure pursuant to the federal interest disclosures law, shall constitute compliance with this statute.

E. 1. Any loan secured by a subordinate mortgage or deed of trust on such residential real estate where the interest is charged at a simple annual interest rate on the unpaid balance thereof may be lawfully enforced at the interest rate stated therein on the principal amount of the loan forborne or contracted to be lent or forborne and such rate may vary in accordance with an exterior standard as permitted in subsection B of § 6.1-330.68.

2. Notwithstanding the foregoing, a service charge not exceeding two percent of the amount of the loan may also be imposed, subject to the eighteen-month limitation specified in subsection A of this section, except to the extent that new money is advanced.

3. In addition to the service charge allowed under paragraph 2 of this subsection, no more than a five percent total charge, discount, initial interest, points, or charge by any other name may be collected, charged or added to the instrument of debtedness during the first year, except for the simple annual interest rate permitted under this subsection on the unpaid balance and except for those charges permitted under § 6.1-330.72. The lender shall rebate on a pro rata basis any charge authorized by this paragraph when the borrower pays off the entire balance of the loan at any time during the first sixty months of the term of the loan.

F. This section and §§ 6.1-330.72 and 6.1-330.85 shall not apply to a seller in a real estate sales transaction who takes a subordinate mortgage on such real estate.

§ 6.1-330.71. Compliance with federal law.–Every financial institution or other lender, in offering or extending consumer credit, shall comply with the provisions of 15 USC 1601 et seq. and Regulation Z, Truth-in-Lending, promulgated by the Board of Governors of the Federal Reserve System.

§ 6.1-330.72. Loans secured by subordinate mortgage; charges allowed; requirements relating to insurance.– A. Any lender making a loan secured by a subordinate mortgage may require the borrower to pay, in addition to the service charge and interest permitted by § 6.1-330.70, the

actual cost of title examination, title insurance, mortgage guaranty insurance, recording fees, surveys, attorney's fees, and appraisal fees. No other charges of any kind shall be imposed on or be payable by the borrower either to the lender or any other party in connection with such loan; provided, late charges in the amount specified in § 6.1-330.79 may be made and, upon default, the borrower may be subject to court costs, attorney's fees, trustee's commission and other expenses of collection as otherwise permitted by law. Broker's or finder's fees may be paid by the lender from the service charge or interest permitted under § 6.1-330.70, or a broker's fee, finder's fee or commission may be paid by the borrower not to exceed two per cent of the amount of the loan if the total interest, service charge, broker's fees, finder's fees or commissions do not exceed the amount of service charges and interest permitted under § 6.1-330.70.

B. Evidence of fire and extended coverage insurance may be required by the lender of the borrower and the premium shall not be considered as a charge. Decreasing term life insurance, in an amount not exceeding the amount of the loan and for a period not exceeding the term of the loan, may also be required by the lender of the borrower and the premium shall not be considered as a charge. At the option of the borrower accident and health insurance may be provided by the lender, and the premium therefor shall not be considered a charge. Proof of all insurance issued in connection with loans subject to this chapter shall be furnished to the borrower within ten days from the date the loan is closed.

C. No charge may be made, except as permitted by § 6.1-330.70, if the loan is not made.

D. This section shall not apply to any loan made by any lender enumerated in § 6.1-330.73.

§ 6.1-330.73. Applicability of §§ 6.1-330.70, 6.1-330.72 and 6.1-330.85.–Sections 6.1-330.70, 6.1-330.72 and 6.1-330.85 shall not apply to loans made by any lender licensed by, and under the supervision of the State Corporation Commission or the federal government, or to loans made by state and national banks, state and federal savings and loan associations and state and federal credit unions.

§ 6.1-330.74. Limiting application of this chapter and other usury sections in actions for recovery of interest under certain contracts insured, etc., by governmental agencies.– A. No person shall, by way of defense or otherwise, avail himself of any of the provisions of this chapter or any other section relating to usury or any statute or rule of case law relating to compounding of interest to avoid or defeat the payment of any interest or fee or any other sum which he shall have contracted to pay on any loan or forbearance of money:

1. Insured by the Federal Housing Administration, pursuant to the provisions of the National Housing Act;

2. Guaranteed by the Veterans Administration, pursuant to Title 38 of the United States Code; or

3. Insured or guaranteed by any similar federal governmental agency or organization, or made directly or indirectly by the Virginia Housing Development Authority pursuant to the provisions of Chapter 1.2 (§ 36-55.24 et seq.) of Title 36.

B. Nothing contained in this chapter shall be construed to prevent the recovery of such interest or fee from any person who shall have contracted to pay the same.

Article 9.

Exceptions to Contract Rate of Interest;

Commercial Transactions.

§ 6.1-330.75. Defense of usury not applicable to certain business loans.–A. No person shall, by way of defense or otherwise, avail himself of the provisions of this chapter, or any other section

relating to usury to avoid or defeat the payment of interest, or any other sum, when such loan is made to a person or entity for the acquisition or conduct of business or investment as a sole proprietor, owner, or joint venturers or owners, provided the initial amount of the loan is $5,000 or more.

B. For the purposes of this section, unless a loan is for family, household, or personal purposes which shall not include a passive or active investment, it shall be deemed to be for business or investment purposes within the meaning of this section.

§ 6.1-330.76. Charges by sellers and lessors of consumer goods; certain premiums not construed as additional charges; penalty for violations of section.

A. Any seller of consumer goods as defined in § 8.9-109 who extends credit under a closed-end installment credit plan or arrangement may impose a service charge not to exceed such rate or rates as may be agreed upon by the seller and the consumer on the balance at the end of the billing period next preceding each successive payment. Deferrals and extensions of the time for payment, if allowed by the seller or his assignee, may be subject to a service charge as set forth in this section, if agreed to in the original contract or at the time of the renewal or extension. No additional charge shall be made for the extension of credit under such a plan or arrangement. If the total service charge on the transaction is precomputed according to the actuarial method, the service charge may be calculated on the assumption that all scheduled payments will be made when due. The balance on which such service charge may be imposed may include the deferred portion of the sales price of the consumer goods and costs and charges incidental to the transaction, including any insurance premium financed in connection therewith. The debtor shall have the right to prepay in full on precomputed transactions, and rebates shall be determined in accordance with the Rule of 78, as illustrated in § 6.1-330.86, or the sum of the digits method or other method elected by the seller under which the service charge imposed on the debtor for the time the debt is outstanding does not exceed the amount permitted hereunder; the seller may also condition such rebate upon the earning of a minimum of twenty-five dollars in service charges, which amount to the extent not earned may be withheld from the rebate required hereunder. A late charge pursuant to § 6.1-330.79 may be imposed.

B. 1. Any lessor of consumer goods as defined in § 8.9-109 may impose a service charge of two percent per month on the balance at the end of the month next preceding each successive payment provided:

a. That the lease agreement is in the form of a bailment or lease of such goods;

b. It is stated in the lease that the lessee will become or has the option to become the owner of such goods for no other consideration or for nominal consideration if he fully complies with his obligations; and

c. The lessor extends credit under a closed-end installment credit plan or arrangement.

2. No additional charge, other than a late charge under § 6.1-330.79, may be had for the extension of credit under such lease.

C. Premium for credit life insurance and credit accident and health insurance purchased by the debtor are not to be construed as an additional charge for the extension of credit if such insurance coverage is purchased voluntarily by the debtor. Premiums for property insurance on the goods purchased are not to be construed as additional charges for extension of credit unless the seller requires the purchase of such insurance from or through the seller.

D. Where a service charge is made by any seller or lessor in excess of that permitted by this section, the provisions relating to usury set forth in §§ 6.1-330.56 and 6.1-330.57 shall apply.

§ 6.1-330.77. Open-end sales and loan plans.–A. Any seller or lender engaged in the extension of credit under an open-end credit or similar plan under which a service charge is imposed upon the cardholder or consumer, if payment in full of the unpaid balance is not received at the place designated by the creditor prior to the next billing date (which shall be at least twenty-five days later than the prior billing date), may charge and collect a service charge at

such rate as may be agreed upon by the seller or lender and the cardholder or consumer. Such rate may be computed at the option of the seller or lender on either:

a. The average daily balance for the period ending on the billing date;

b. The balance existing on the billing date of the month; or

c. Any other balance which does not result in the seller or lender charging and receiving any sum in excess of what would be charged and received in a. or b. of this paragraph.

2. No service charge shall be charged unless the bill is mailed not later than eight days (excluding Saturdays, Sundays and holidays) after the billing date, except that such time limitation shall not apply in any case where the seller or lender has been prevented, delayed, or hindered in mailing or delivering the bill within such time period because of an act of God, war, civil disorder, natural disaster, strike, or other excusable or justifiable cause.

3. Notwithstanding the provisions of this section, a seller or lender may charge and collect a minimum service charge of one-half dollar per month; however, no service charge shall be charged against a zero balance.

4. For the purposes of this section the average daily balance for any period shall be that amount which is the sum of the actual amounts outstanding each day during the period, divided by the number of days in the period.

B. Notwithstanding the provisions of § 6.1-330.70 of the Code of Virginia, any loan made under this section may be secured in whole or in part by a subordinate mortgage or deed of trust on residential real estate improved by the construction thereon of housing consisting of four or less family dwelling units. For the purposes of this chapter relating to money and interest, a subordinate mortgage or deed of trust is one subject to a prior mortgage or deed of trust in existence at the time of the making of the loan secured by such subordinate mortgage.

C. Except where the rate varies in accordance with an exterior standard which is agreed to in the obligation of indebtedness, no increase in service charge rate shall take effect unless at least thirty days prior to the effective date of such increase a written notice of the increase has been mailed or otherwise delivered to the cardholder or consumer explaining that the making of additional charges under the plan on or after the effective date of the increase shall be deemed to constitute acceptance of such higher charge on existing balances and charges incurred thereafter under the plan.

§ 6.1-330.78. Corporations, partnerships, professional associations, real estate investment trusts and certain joint ventures not allowed to plead usury.–No corporation, partnership which is required to file a certificate pursuant to Chapter 2 (§ 50-44 et seq.) or Chapter 3 (§ 50-74 et seq.) of Title 50 or which is formed under laws other than those of this Commonwealth, professional association, or real estate investment trust, or joint venture organized for the purpose of holding, developing and managing real estate for profit, shall, by way of defense or otherwise, avail itself of any of the provisions of this chapter or any other section relating to usury to avoid or defeat the payment of any interest or any other sum which it has contracted to pay. Nothing contained in any of such sections shall be construed to prevent the recovery of such interest or any other sum, though it be more than contract rate of interest and though that fact appears on the face of the contract.

Article 10.

Late Charges; Prepayment and Acceleration Laws;

Certain Rights of Borrower.

§ 6.1-330.79. Amount of late charge; when charge can be made.–A. Any lender or seller may impose a late charge for failure to make timely payment of any installment due on a debt,

whether installment or single maturity, provided that such late charge does not exceed five percent of the amount of such installment payment and that the charge is specified in the contract between the lender or seller and the debtor. For the purposes of this section, "timely payment" is defined as one made by the date fixed for payment or within a period of seven calendar days after such due date. Late charges shall not be deemed to include charges imposed upon acceleration of the entire debt or to include costs of collection and attorney's fees as otherwise permitted by law by reason of a default by the debtor.

B. If any federal governmental agency or organization shall adopt any rules or regulations dealing with the application of late penalties as to loans insured or guaranteed by such federal agency or organization, then such rules and regulations shall control as to such loans insured or guaranteed by them.

C. Any late charges in excess of the amount permitted by this section shall be void as to such excess but shall not otherwise affect the validity of the obligation.

§ 6.1-330.80. Certain contracts to permit prepayment; amount of prepayment penalty.– A. Every contract, except as provided in subsection C of this section, made for the loan or forbearance of money and secured by a first deed of trust or first mortgage on real estate, where the amount loaned or forborne is less than $75,000, shall permit the prepayment of the unpaid principal at any time and no penalty in excess of 1% of the unpaid principal balance shall be allowed.

B. Any prepayment penalty provision in violation of this section shall be unenforceable as to the amount in excess of one percent of such balance.

C. The provisions of this section shall not apply to secured or unsecured notes evidencing installment sales contracts. The provisions of this section relating to prepayment penalty shall not apply to contracts as provided in §§ 6.1-330.82, 6.1-330.83, and 6.1-330.84 or to contracts otherwise governmentally regulated as to prepayment privilege, made for the loan or forbearance of money.

§ 6.1-330.81. Property owner entitled to written statement of payoff amount.–A. Where a lien on real estate is secured by a deed of trust or mortgage, the owner of such real estate, if entitled to prepay the obligation secured by such deed of trust or mortgage, shall be entitled to receive from the bank, savings and loan association or other corporate entity holding such obligation, a written statement setting forth the total amount to be paid as of a particular date in order to obtain a release of the deed of trust or mortgage. The holder of the obligation secured by said deed of trust or mortgage shall mail or deliver such written statement of the payoff amount to the property owner or his designee within ten business days of the receipt of a written request for such payoff information from the property owner or his designee if the request contains the loan number and the address or other description of the location of the subject premises. Upon payment in full of the obligation, the holder shall promptly cause the cancelled loan documents to be forwarded to the owner or his designee. An inadvertent error made in the calculation of the payoff amount shall not release the party liable for payment of the obligation from the requirement to pay the full amount due under the obligation, nor shall it release the holder of the obligation from the requirement to return any overpayment to such party or his designee.

B. A request for payoff information under this section may be made one time within a twelve-month period without charge, and a fee not exceeding fifteen dollars may be charged for each additional request made within such period.

§ 6.1-330.82. Prepayment by borrower from credit union.–A borrower from a credit union may prepay the whole or any part of his loan at any time, without penalty.

§ 6.1-330.83. Prepayment penalty for loan secured by home occupied by borrower.– The prepayment penalty for a loan secured by a home which is occupied or to be occupied in whole or in part by a borrower shall not be in excess of a sum equal to two percent of the amount of such prepayment.

§ 6.1-330.84. Prepayment by borrower from industrial loan association; rebates for unearned

interest; prepayment penalty.–Any natural person borrowing from an industrial loan association shall have the right to anticipate payment of his debt at any time. In cases where interest has been added to the face amount of the note, such person shall have the right to receive a rebate by way of credit for any unearned interest, which rebate shall be computed in accordance with the Rule of 78 as illustrated in § 6.1-330.86 or by using any other method that is at least as favorable to such borrower. In addition, the industrial loan association may charge a prepayment penalty not to exceed two percent of the amount of the prepayment, provided such prepayment penalty, including the percent thereof, is set forth in the instrument evidencing the debt and disclosed to the borrower pursuant to the federal interest disclosure laws.

§ 6.1-330.85. Prepayment of loan described in § 6.1-330.70; rebates for unearned interest.–A. Any borrower under any loan described in § 6.1-330.70 shall have the right to anticipate payment of his debt in whole or in part at any time. In cases where the interest has been added to the face amount of the note, any borrower shall have the right to receive a rebate by way of credit for any unearned interest, which rebate shall be computed in accordance with the Rule of 78 as illustrated in § 6.1-330.86.

B. The provisions of this section shall not apply to any loan made by any lender enumerated in § 6.1-330.73.

§ 6.1-330.86. The Rule of 78.–A. The Rule of 78 is so named because the months of one year, i.e., one through twelve added together, total seventy-eight.

B. To determine the amount of the rebate of unearned interest under the Rule of 78 on a loan where payment is anticipated:

1. Determine the number of months over which the loan is to be repaid according to its terms. Write the numbers in sequence and add (for example, for a four-year loan write the numbers one through forty-eight). The total will be the denominator of a fraction to be determined below.

2. Determine the number of months remaining on the loan after payment is anticipated. Write in inverse sequence and add (for example, for a four-year loan anticipated after the third month, write the numbers forty-five back to one). The total will be the numerator of the fraction of which paragraph 1 of this subsection is the denominator.

3. Multiply the original amount of interest that would have been paid over the life of the loan by the fraction derived in paragraphs 1 and 2 of this subsection. Such figure, so determined, is the amount to be rebated.

C. Payment anticipated between scheduled payment dates shall not be considered but instead the succeeding scheduled payment date shall be used in determining the rebate under subsection B of this section.

§ 6.1-330.87. Prepayment penalties not to be collected in certain circumstances.–No lender shall collect or receive any prepayment penalty on loans secured by real property comprised of not more than four family residential dwelling units, if the prepayment results from the enforcement of the right to call the loan upon the sale of the real property which secures the loan. If the loan is prepaid because of sale to a person whom the lender has rejected as a grantee or failed to approve within fifteen days after receipt by it of written request for approval, such prepayment shall be presumed to result from enforcement of the right to call the loan.

§ 6.1-330.88. Mortgage, etc., to contain notice that debt is subject to call or modification on conveyance of property.–Where any loan is made secured by a mortgage or deed of trust on real property comprised of not more than four family residential dwelling units, and the note, or mortgage or deed of trust evidencing such loan contains a provision that the holder of the note secured by such mortgage or deed of trust may accelerate payment of or renegotiate the terms of such loan upon sale or conveyance of the security property or part thereof, then the mortgage or deed of trust shall contain in the body or on the margin thereof a statement, either in capital letters or underlined, which will advise the borrower as follows: "Notice –The debt secured hereby is subject to call in full or the terms thereof being modified in the event of sale

or conveyance of the property conveyed."

§ 6.1-330.89. Acceleration clause in note evidencing installment loan; effect of acceleration.– Any note evidencing an installment loan at an add-on rate may provide that the entire unpaid loan balance, at the option of the holder, shall become due and payable upon default in payment of any installment without impairing the negotiability of the note, if otherwise negotiable. Upon such acceleration, the lender shall not be entitled to judgment for unearned interest, but the balance owing shall be computed as if the borrower had made a voluntary prepayment and obtained as of the date of acceleration an interest credit based upon the Rule of 78 as defined in § 6.1-330.86. Such accelerated balance shall bear interest at the rate shown, or which should have been shown if a consumer transaction were involved, as the annual percentage rate under a truth-in-lending disclosure pursuant to federal law.

§ 6.1-330.90. Right of buyer of consumer goods to refinance certain payments; agreements as to fluctuation in schedule of payments.–A. In any sales transaction, except one pursuant to an open-end account, involving exclusively consumer goods as defined in paragraph (1) of § 8.9-109 wherein credit is extended and a security interest in consumer goods is taken, any installment payment, other than a down payment made prior to or contemporaneously with the execution of an agreement evidencing the transaction, which is more than ten percent greater than the regular or recurring installment payments, shall be subject to the buyer's right to refinance such a payment on the basis of an extended period of time. Such additional payments shall be in amounts which shall allow the unpaid balance to be paid in as few periodic payments, not more than ten percent greater than the regularly scheduled installment payments, as are required to pay such balance. Such additional payments shall be considered and treated as part of the original transaction.

B. The parties may agree in a separate writing that one or more payments or the intervals between one or more payments shall be reduced or expanded in accordance with the desires or needs of the buyer, if such fluctuations in the schedule of payments are expressly arranged to coincide with the anticipated fluctuations in the buyer's capability to make such payments.

C. No seller who has refused to refinance in compliance with the provisions of this section shall be entitled (i) to return or repossession of the goods involved in the transaction or (ii) to a judgment for the unpaid balance involved in the transaction at the time of his failure to do so.

2. That Chapter 7.2 of Title 6.1 of the Code of Virginia, containing Articles numbered 1 through 10 and sections numbered 6.1-330.6 through 6.1-330.48 is repealed.

3. That the repeal of the provisions of § 6.1-330.47 of the Code of Virginia by this Act is with respect to loans secured by subordinate deeds of trust or mortgages which are closed on or after July 1, 1986. Notwithstanding its repeal with respect to such loans, the provisions of § 6.1-330.47 shall continue to apply to loans secured by subordinate deeds of trust or mortgages closed prior to July 1, 1986. For the purposes of this enactment clause, a loan shall be deemed closed upon the original recordation of the deed of trust or mortgage securing such loan.

Comparative Table

New section	Old section
Article 1.	
6.1-330.49	New
Article 2.	
6.1-330.50	6.1-330.6
6.1-330.51	6.1-330.7
6.1-330.52	6.1-330.8
Article 3.	
6.1-330.53	6.1-330.9
6.1-330.54	6.1-330.10
Article 4.	
6.1-330.55	6.1-330.11
Article 5.	
6.1-330.56	6.1-330.45
6.1-330.57	6.1-330.46
6.1-330.58	6.1-330.47

Article 6.

6.1-330.59	6.1-330.13:1
6.1-330.60	6.1-330.44
6.1-330.61	6.1-330.41
6.1-330.62	6.1-330.19:1
6.1-330.63	6.1-330.18

Article 7.

6.1-330.64	6.1-330.42
6.1-330.65	6.1-330.42:1
6.1-330.66	6.1-330.44:1
6.1-330.67	6.1-330.15

Article 8.

6.1-330.68	6.1-330.37
6.1-330.69	6.1-330.23
6.1-330.70	6.1-330.16
6.1-330.71	6.1-330.17
6.1-330.72	6.1-330.24
6.1-330.73	6.1-330.25
6.1-330.74	6.1-330.38

Article 9.

6.1-330.75	6.1-330.44
6.1-330.76	6.1-330.21
6.1-330.77	6.1-330.20
6.1-330.78	6.1-330.43

Article 10.

6.1-330.79	6.1-330.26
6.1-330.80	6.1-330.27:1
6.1-330.81	6.1-330.27:2
6.1-330.82	6.1-330.28
6.1-330.83	6.1-330.29
6.1-330.84	6.1-330.30
6.1-330.85	6.1-330.31
6.1-330.86	6.1-330.32
6.1-330.87	6.1-330.33
6.1-330.88	6.1-330.34
6.1-330.89	6.1-330.35
6.1-330.90	6.1-330.36

Comparative Table

Old section		New section
	Article 1.	
6.1-330.6		6.1-330.50
6.1-330.7		6.1-330.51
6.1-330.8		6.1-330.52
	Article 2.	
6.1-330.9		6.1-330.53
6.1-330.10		6.1-330.54
6.1-330.11		6.1-330.55
	Article 3.	
6.1-330.12		Repealed
6.1-330.13:1		6.1-330.59
6.1-330.14:1		6.1-330.59
6.1-330.15		6.1-330.67
6.1-330.16		6.1-330.70
6.1-330.17		6.1-330.71

Article 4.

6.1-330.18	6.1-330.63
6.1-330.19:1	6.1-330.62
6.1-330.20	6.1-330.77
6.1-330.21	6.1-330.76

Article 5.

6.1-330.23	6.1-330.69
6.1-330.24	6.1-330.72
6.1-330.25	6.1-330.73

Article 6.

6.1-330.26	6.1-330.79

Article 7.

6.1-330.27:1	6.1-330.80
6.1-330.27:2	6.1-330.81
6.1-330.28	6.1-330.82
6.1-330.29	6.1-330.83
6.1-330.30	6.1-330.84

Article 7. (continued)

6.1-330.31	6.1-330.85
6.1-330.32	6.1-330.86
6.1-330.33	6.1-330.87
6.1-330.34	6.1-330.88
6.1-330.35	6.1-330.89
6.1-330.36	6.1-330.90

Article 8.

6.1-330.37	6.1-330.68
6.1-330.38	6.1-330.74
6.1-330.39	Repealed
6.1-330.40	Repealed
6.1-330.41	6.1-330.61
6.1-330.42	6.1-330.64
6.1-330.42:1	6.1-330.65

Article 9.

6.1-330.43	6.1-330.78
6.1-330.44	6.1-330.60
	6.1-330.75
6.1-330.44:1	6.1-330.66

Article 10.

6.1-330.45	6.1-330.56
6.1-330.46	6.1-330.57
6.1-330.47	6.1-330.58
6.1-330.48	Repealed

VIRGINIA MORTGAGE ASSOCIATION

September 12, 1985

FORWARDING LETTER CONCERNING DRAFT LEGISLATION

Enclosed find a copy of the draft legislation proposed by the VIRGINIA MORTGAGE ASSOCIATION concerning interest rates.

Sincerely,

William D. Robertson
President

§ 6.1-330.16 <u>Loans by other than supervised licensed lenders secured by subordinate mortgages or deeds of trust</u>.

A. The following definitions shall apply to this section:

"Regulation Z": Regulation Z issued by the Board of Governors of the Federal Reserve System to implement the federal Truth in Lending and Fair Credit Billing Acts, contained in Title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 et seq.).

"Date of Disbursement": the date upon which the Lender disburses to the borrower or for the borrower's account the proceeds of any loan made pursuant to this Section.

"Interest": the cost of consumer credit as a dollar amount, including Periodic Interest as defined in this Section and any other charge payable directly or indirectly by the borrower and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit, which is not expressly excluded under Subsection F of this Section.

"Amount of Loan": the amount of credit provided to a borrower or on his behalf, which shall be calculated by determining the proceeds of a loan to be disbursed to or for the account of the borrower, adding any other charges permitted by this Section to be financed by the Lender.

"Prepaid Interest": any Interest paid separately in cash or by check before or at the Date of Disbursement of a loan, or deducted at the Date of Disbursement from the proceeds of the Amount of Loan.

"Lender": any person, firm, corporation, partnership or other entity which is not licensed by and under the supervision of the State Corporation Commission or the federal government or otherwise enumerated in §§ 6.1-330.25 and 6.1-330.48 of this Code.

"Loan Broker": any person, firm, corporation, partnership or other entity who contracts with a borrower to assist the borrower in obtaining a loan from a Lender.

"Periodic Interest": amounts payable by a borrower as a result of application of the periodic interest rate set forth in the note evidencing a loan made pursuant to this Section to the outstanding Amount of Loan.

B. Any Lender may charge any Interest for making a loan which is secured in whole or in part by a subordinate mortgage or deed of trust on residential real estate consisting of one-to-four family dwelling units, provided that the Lender makes any disclosures required of such Lender by Regulation Z and provided that such Lender collects no more than an amount equal to ten percent of the Amount of Loan as Prepaid Interest. In calculating the ten percent limitation set forth in this subsection, a Lender may exclude an amount equal to the Periodic Interest due on the loan from the Date of Disbursement to a date not more than thirty days prior to the date of the first scheduled installment payment due under the note evidencing the loan; provided that such first installment payment shall be due and payable not more than sixty days after the Date of Disbursement. For purposes of this Chapter 7.2 (§ 6.1-330.6 et seq.) relating to money and interest, a subordinate mortgage or deed of trust is one subject to a prior mortgage or deed of trust in existence at the time of the making of the loan secured by such subordinate mortgage.

C. Any Prepaid Interest permitted by this Section may be collected by a Lender and shall be fully earned and non-refundable at the Date of Disbursement of a loan.

D. A Lender may not collect any amount of money from a borrower if a loan is not made, except to reimburse the Lender for actual costs of the Lender expended for a credit report and real estate appraisal conducted in connection with the loan application. Such amount shall not exceed in the aggregate the lesser of one percent of the amount of the loan applied for, fifty dollars or one-half of such actual costs. A Lender may collect such amount only if the Lender has committed in writing to make the loan.

E. Any loan made by a Lender before the effective date of this section shall be deemed to have been made in compliance with former § 6.1-330.16 if the Lender made the disclosure required by Regulation Z.

F. For purposes of this Section, the following charges shall not be considered Interest. To the extent such charges are then due, they may be paid by the borrower either separately by cash or check at the Date of Disbursement of the loan or, at the borrower's option, may be deducted from the proceeds of the Amount of Loan:

(i) the actual cost of title examination, title insurance, mortgage guaranty insurance, recording fees, surveys, attorney's fees and appraisal fees; and

(ii) premiums for fire and extended coverage insurance for a policy period not to exceed one year from the Date of Disbursement; and

(iii) if the borrower elects such coverage, premiums for decreasing term life insurance in a face amount not exceeding the amount of the loan and for a period not exceeding the term of the loan; and

(iv) if the borrower elects such coverage, premiums for accident and health insurance to provide a source of repayment of the loan in the event of illness or disability of the borrower; and

(v) amounts payable by the borrower to a Loan Broker with whom the borrower has contracted independently of the Lender.

G. Any loan made pursuant to this Section shall be evidenced by the borrower's promissory note setting forth the annual rate of Periodic Interest, which periodic interest rate may vary in accordance with an exterior standard as provided in Section 6.1-330.37 of this Code, that will be charged on the outstanding balance of the Amount of Loan from the Date of Disbursement to the date of repayment. Any loan made pursuant to this Section may be made on an add-on basis where interest is charged in advance at the periodic interest rate stated in the note on the entire Amount of Loan for the term thereof; provided that Prepaid Interest on such add-on loan shall not exceed two percent of the Amount of Loan, such add-on Periodic Interest Rate shall not be variable and the note shall provide for rebate of unearned Periodic Interest in accordance with the Rule of 78 in the event of prepayment of the loan in full prior to maturity. Reference is made to § 6.1-330.32 for illustration of the Rule of 78.

H. The Prepaid Interest permitted by this Section shall not be chargeable by the Lender upon refinancing by the same Lender of the unpaid balance of any loan made pursuant to this Section. Such Prepaid Interest may be charged on any additional amounts lent by the Lender not required to refinance the outstanding balance of such loan.

I. A note evidencing a loan made pursuant to this Section may provide for the payment of late charges in the amount specified in § 6.1-330.26 of this Code and for payment, in the event of default, of court costs, attorney's fees, trustee's commission and other expenses as otherwise permitted by law.

J. To the extent that decreasing term life insurance or accident and health insurance is obtained through the Lender in connection with a loan made pursuant to this Section, proof of such insurance shall be provided to the borrower by the Lender within ten days after the Date of Disbursement.

Section 6.1-330.24 Repealed

Section 6.1-330.31 Repealed

Section 6.1-330.47 Repealed

Section 6.1-330.48 Repealed

APPENDIX 4

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Statement of John E. Whitfield to
the Joint Subcommittee Studying
Savings and Loans, Interest Rates
and Interstate Banking

Thank you for affording me this opportunity to briefly address this subcommittee. I'm John Whitfield, a staff attorney with Blue Ridge Legal Services, a "legal aid" organization in Harrisonburg, Virginia. I am here on behalf of 8 clients who have borrowed money from an unregulated second-mortgage lender in the Commonwealth. All 8 of these families are low-income households and most were attracted by the lender's advertisements that were obviously targeted at people with poor credit ratings. One family lost their home. Most of the others came very close to losing their homes as a result of these loans.

All 8 families were loaned money at a stated rate of 18%. But, in addition to the 18% actuarial interest charged on the amount lent, they were charged something called "loan discount points" averaging over 33% of the amount borrowed. If this wasn't enough, they were then charged 18% interest on these points, since the points were not paid by the borrowers, but financed and added to the face value of the note. As a result, the annual percentage rates were usually 9 to 10 percentage points higher than the 18% stated in the notes.

Of course, members of this joint subcommittee will know that interest rate ceilings were lifted several years ago. Borrowers and lenders are now left free to negotiate an interest rate, or the market decides the rate. However, the practice of charging substantial "loan discount points" in addition to the actuarial interest complicates and distorts this process. In most cases of which I am aware, the borrowers were thoroughly confused as to the effect of the "loan discount points" upon the effective interest rate involved and believed that they were paying only 18%. As a result, they entered into loans that they may not have made if the "loan discount points" had been simply replaced by a higher interest rate stated in the note.

A second consequence of this practice of charging "loan discount points" results if a borrower prepays the note in full, or if he defaults and the note is accelerated by the lender. Under the present statutory scheme, it is clear that second-mortgage lenders must rebate any unearned interest, calculated by the Rule of 78's, in the event of a prepayment or default. However, in the cases in which I am involved, the lender claims in the loan papers that the "loan discount points" are fully earned at the time of the transaction, as opposed to the 18% actuarial interest stated on the note, which is earned over the course of the note's term. As a result, if a borrower prepays or defaults upon his note only one year after it is made (assuming that the "loan discount points" amounted to 33% of the amount he borrowed) he would have been charged interest equal to 51% of the amount he borrowed over that year. If prepayment or default occurs even more quickly, the resulting interest rate per annum increases astronomically. In other words, the quicker the default, the more profitable it becomes for the secured lender. This would not occur if the loan transaction had substituted a higher actual interest rate for the "loan discount points", yet the lender could still earn a profitable rate of return.

There is certainly an issue as to whether this practice may be already prohibited by existing state law. However, the issue has not yet been decided by any court in Virginia, and the practice has continued unabated now for several years in epidemic proportions in Virginia. Whether the practice is prohibited, nobody knows for sure.

If the practice is prohibited under existing state law, then enforcement of those statutes has been woefully inadequate in light of the thousands of loans made in the last two years involving these "loan discount points". No state agency has been regularly monitoring the activities of the second-mortage lenders. If the practice is prohibited, something needs to be done to ensure compliance.

On the other hand, if this practice is not prohibited, this subcommittee should consider taking some action to control it. When the General Assembly enacted the Small Loan Act years ago, it did so in order to protect the unwary and unsophisticated low-income borrower from the sharp practices and abuses of some small loan companies. Under that Act, small loan companies are licensed and regulated by the State Corporation Commission. The amount of interest they can charge is limited. The amount of money they can loan to a borrower is limited. Yet, we are now faced with some unregulated, second-mortgage lenders who are preying on the same segment of the Commonwealth's citizenry sought to be protected by the Small Loan Act. These lenders are making loans in excess of the limitations imposed by the Small Loan Act. They are charging

charging exorbitant interest charges in the form of "loan discount points", something that small loan companies cannot do. It is ironic that these second-mortgage lenders are allowed to escape these limitations and regulations simply because they are taking second deeds of trust in the borrowers' homes. If these borrowers need protection, they need it most when they are putting up their homes as security for a loan.

For these reasons, I hope you will consider the needs of my clients, and others like them, and review the status of second-mortgage lenders in the Commonwealth, together with their ability to impose "loan discount points".

CHARLOTTESVILLE-ALBEMARLE

ALAS

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SUITE 202
CHARLOTTESVILLE, VIRGINIA 22901
(804) 972-1770

June 17, 1985

Statement of: Edward M. Wayland, Esq.
Senior Staff Attorney
Charlottesville-Albemarle Legal Aid Society
413 East Market Street
Charlottesville, Virginia 22901
(804) 972-1770

My purpose in making this statement is to bring to the attention of this body a problem which calls out for legislative investigation and the enactment of appropriate corrective legislation. The problem concerns abuses in the home mortgage business in Virginia, with particular emphasis on second mortgages.

I currently represent half a dozen families who have entered into second mortgage loan transactions with a certain company operating in Virginia. In addition, over the past several months, I have been contacted by several dozen other persons in various parts of the state who have entered into such transactions with the same company. An examination of the terms of these loans, and with the processes used by this company in attracting customers and in setting up the loans, reveals a number of very disturbing practices.

The loan transactions which I have reviewed all follow the same pattern. As an example, the customer will approach the loan company for the purpose of borrowing, say, $10,000. The loan

JUSTICE

documents which result recite a principal loan amount of, not $10,000, but $13,500. Most of the excess $3,500 will be allocated to what is described as "loan discount points." The customer, under the terms of the loan agreement, must repay the entire $13,500, at the contract rate of interest, which generally varies from 16% to 18%. The customer actually receives, however, only the $10,000 originally requested.

There are at least three serious problems with the transactions I have reviewed. First, there is the fact of this excessive "points" charge. I have seen loans with "discount points" charged in excess of 40% of the amount actually received by the borrower. In addition, several of my clients have taken out loans with this company only to fall hopelessly behind on their payments. The company then refinances the loans, including in the principal of the new loan the entire amount of "points" originally charged. A new charge for "points" on the new loans, again calculated at 25% to 40%, is then assessed. When the total amount of the "points" charged in the two loans is compared to the total actually received by the borrower, the percentage rises to 55% or 60% or more.

Such charges are plainly outrageous, and are wholly out of line with similar charges imposed by other companies operating in this industry.

A second problem with this company's practice is that many of the borrowers are not made aware of precisely what is happening with these loans. We have received regular reports that the loan documents are presented for signature by the borrower in blank or incompletely filled in. The Promissory Notes borrowers sign do not make any mention of these extra and exorbitant charges. There is in fact no place in any of the loan documents used where a statement appears to the effect that the borrower understands and agrees to these charges. Attorneys who are asked to examine the loan documents are usually able to determine the true nature of the transaction only after considerable study of the documents, and even then there are key facts which are not disclosed.

The final problem presented by these loans is the absense of a clear remedy. The second mortgage industry is not regulated in Virginia, and there is, consequently, no place in state government to whom an aggrieved borrower may turn for protection from these practices. The Virginia usery laws, found at §6.1-330.1 et seq. of the Code of Virginia, purport to deal with such loans, but the statutes have been amended and re-amended to the point that there are many unanswered questions about exactly what they mean when applied to these transactions. Attorneys who have attempted to make sense of these statutes have expressed conflicting views regarding their application to these loans.

In parts of this state borrowers who are the victims of this company's practices are suffering from an epidemic of foreclosures. People are losing their homes.

So far as I am aware there are only one or two mortgage lending companies in Virginia which are victimizing borrowers in this way. If they are permitted to proceed uninvestigated and unchecked, however, it seems clear that others in that industry will be tempted, or will be forced by competitive pressures, to adopt similar tactics. This will become the norm, instead of an outrageous and abusive exception.

Such a result must be avoided. I urgently request that hearings be held on these practices and that appropriate legislation be enacted to protect unsuspecting borrowers from this sort of shameless exploitation.

3404 Harrow Cross
Virginia Beach, Virginia 2345?
23 September, 1985

Virginia Interest Rate Subcommittee Members
George H. Heilig, Jr.
William F. Parkerson, Jr.
Franklin P. Hall
Vincent F. Callahan, Jr.
R. J. Holland

RE: HJR 217 Committee Meeting held on 16, September, 1985

Gentlemen:

I read with interest the Norfolk Virginian Pilot article of September 17, 1985, written by Mr. Warren Fiske, Staff writer for that newspaper relative to the referenced meeting. I later received a copy of your agenda for the referenced meeting and a copy of the draft legislation proposed by the recently organized Virginia Mortgage Association concerning interest rates.

Frankly, I am astounded at the content of subject proposal by Mr. Robertson and dismayed that a committee of your importance would waste so much time on such an amateurish approach to gutting the g provisions of existing Virginia law and substituting measures t would make legitimate a second mortgage loan-sharking operation blessed by legislative approval. We need serious modifications to our current inadequate 2nd Mortgage Laws.

The proposal is mostly rearranging of the items that the "broker-lenders" do not object to while skillfully trying to legalize unconscionable charges and practices to ensure being able to continue "doing business as usual". Surely we can do better!

My recommendations below are based upon over 20 years experience in this lending area with Cameron-Brown Co. and First & Merchants/Sovran with the final 15 years as head of the latter 2nd Mortgage Affiliate. I am retired and the comments contained in this letter are mine alone with no corporate affiliation whatsoever:

RECOMMENDATIONS:

1. Repeal Sections of 6.1-330.16--E&F in entirety. It is beyond my comprehension as to how these sections were ever passed by the Virginia Legislature. They actually come close to making legitimate all of the horror transactions we are reading about currently and point out the direction to go for the numerous interested offenders. And to indicate that an add-on rate is an interest rate stated therein is being pretty naive. And the offenders are using that confusing mumbo-jumbo

about "Disclosure of charges, not otherwise specified in the note, deed of trust, or mortgage, in an interest disclosure pursuant to the federal interest disclosures law, shall constitute compliance with this statute", as justification for "anything goes" or escape clause. What does it really mean - you get a different answer each time you ask.

2. Prohibit the use of an add-on rate for terms in excess of five years (60 months) as the earnings are greatly distorted over the longer terms to the detriment of the borrower who pre-pays the loan for <u>any reason</u>. And most of these loans are paid early by the end of the fourth year. Even the U. S. Congress is currently studying this action!

3. Restrict up-front points to some reasonable and justifiable level such as 5% maximum with a pro rata rebate of any in excess of two (2), at time of early pay-off (for any reason - acceleration or voluntary pre-payment). In other words, don't reward a lender or make it profitable for him to terminate the loan early.

4. Revise Section 6.1-330.15 (and others tied in) to bring all second mortgages under the same rules rather than dependent upon how the lender is licensed! A typical borrower is just not sophisticated enough to walk through this mine field without some legislative fairness. The Industrial Loan provisions are favored and protected for some reason unknown to me, but I say to you that it is time to take a look at this "License to Steal". Already the unregulated lenders are saying privately that they will just go through the Industrial Loan Company's if the loan restrictions are made too tight for their large fees. It is common knowledge that several industrial loan companies are openly operating all over the State of Virginia as well as beyond, through "Brokers" and this is certainly beyond the intended legislative approval of a one-office operation.

5. Repeal Paragraph D of Section 6.1-330.24.

6. Repeal Section 6.1-330-25 in entirety to avoid conflicting limits based upon licensing and/or supervision which a borrower has little if any knowledge about.

7. Designate a supervisory authority over junior lien lenders and brokers to license, examine and enforce the provisions of the enacted legislation. The cost of such activity can easily be borne by fees to the licensees as in other States (Maryland, Ohio, etc.) Without an annual examination or resolving authority (upon complaint) having authority for examination, the present disastrous situation will continue (LANDBANK EQUITY and there are others). Let's act in a responsible fashion, people are losing their homes or worse as a result of letting this "looking the other way" routine continue.

8. Revise Section 6.1-330.47 since the courts for some reason simply will not use the Null & Void penalty. Times have changed and a more appropriate penalty of loss of all interest is fair and will surely get the attention of any lender.

I do not intend to dignify the VMA's proposal by dissecting the same to you but I caution you on this issue - There is no such term as "Periodic Interest" unless you are talking about "Open-end" credit or a variable rate mortgage and this proposal creates several new t[illegible] and definitions which are in violation of Regulation Z, Federal T[illegible] in-lending Act, 15 U.S.C. Section 1601 <u>et seq</u> and of the regulations promulgated thereunder. We just cannot rewrite Regulation Z in this manner. Many of the definition terms used are rewrites of what Federal Law says those terms mean and are conflicting.

I do not propose that the above recommendations are all-encompassing but they surely are a step in the right direction. My purpose is not to see a large group of "Broker-Lenders" put out of business but rather to see a fair and responsible law enacted which will clearly define limits while protecting the unsophisticated (elderly and uneducated) from persons preying on their misfortune, while reaping unconscionable profits.

I wish you much success in your endeavor and will hope that my comments are accepted as constructive support of your sensitive task.

Very truly yours,

Dwain Wise

Dwain Wise

December 16, 1985

TO: Virginia Interest Rate Subcommittee Members

FROM: Dwain "Doc" Wise
Retired Mortgage Executive

SUBJECT: HJR 217 Committee Meeting of December 16, 1985

REF: My letter of September 23, 1985 to Subject Committee

Gentlemen,

In my letter of September 23, I made certain specific recommendations to this committee and I would like to review and update those recommendations where required with one new and easily-workable definitive solution.

Recommendation 1 - Repeal Sections E & F of 6.1-330.16 in entirety.
Update -- No change.

Recommendation 2 - Restrict Add-on loans to 60-62 months.
Update -- No change.

Recommendation 3 - Restrict up-front fees (charges) to 2% with a pro-rata rebate of any above that figure up to 5% maximum.
Update -- Recent observed abuses lead me to believe we should hold with the 2% service charge to avoid jumping back into the fire!
Legitimate Lenders can live with 2% and Brokers-posing -as-Lenders are asking the borrowers to pay for misleading and large advertising expenditures that are to the borrowers detriment.
Maryland permits 2%, Ohio and North Carolina permit none, yet there is no shortage of lenders in those states.
A 13.95% up-front (initial Interest) charge with an interest rate of 14.75% which is ballooned or accelerated at the end of 12 months nets the Lender a yield of 33.76%! It would be a yield of 25.07% ballooned at the end of the 2nd year!

Recommendation 4 - Put Industrial Loan Co's on the same restrictions on Junior liens as all other lenders have. Limit the loan type rather than Lender status.
This Commission has been misinformed --

A. Industrial Loan Co's pay no more for their money than many other lenders -- (example is Essex Industrial of Norfolk advertising a 12.63% APR - simple interest rate of 12.25%) while leading this commission to believe they are paying 14% for their money. It doesn't make any sense! See Attached Ad
B. Additionally, most of those eleven (11) Industrial Loan Co's are a conduit for FNMA purchased second mortgages wherein the lender gets Fee income and servicing income while exporting loans out of Va. that many Va. Lenders could, would, and should be making. These loans are not being presented to FNMA as the "high-risk" loans you have been told about.

C. They are competing for the same customers or why do they advertise in the yellow pages and regular newspapers for the same customer as other lenders? They do not "Appeal" to the high risk customer!

D. We call Industrial Loan Co's "Regulated Lenders" but in fact, do they need regulating if they have no limits? See Section 6.1-330.15!

UPDATE: I recommend a much closer look by this commission to verify the need for such an unrestricted lender. And certainly they should be prohibited from taking brokered loans from all over the State under a one-office license, i.e. **FREEDLANDER AND ESSEX.**

Recommendation 5 - Repeal Para D. of Section 6.1-330.24.
Update - No Change.

Recommendation 6 - Repeal Section 6.1-330.25 in entirety.
Update - No Change.

Recommendation 7 - Designate a supervisory authority with power to examine and enforce the new provisions.
Update - Same Opinion - You have done Nothing without this Action!
Who can a victimized party appeal to?

Recommendation 8 - Revise Section 6.1-330.47 the Null and Void Penalty.
Update - Keep it as is! It didn't phase **LANDBANK** and there are numerous others doing the same or similar violatio of the Spirit of the Law, if not the Content.
Foreclosures are Rampant in all areas of Va. based on sales Ads. And most occur within the first 2 years which makes the up-front charges extremely important.

NEW RECOMMENDATION - So Simple that we have all over-looked it! We didn't have these abuses in the 1960's and 1970's! Why? Because a provision was contained in the second mortgage act that required the Lender to forward a certified copy of the "Settlement Statement" on every junior lien to the SCC for review and retention! Coupled with recommendation 7 above, this inexpensive and simple procedure will straighten out our dilemma (mess) in a rapid manner and preserve our Virginia Mortgage Industries' good name. What valid objection can any Lender have to this procedure which is not without precedent?

REMEMBER -- Landbank wasn't caused -- **IT WAS PERMITTED.**

Respectfully,

Dwain "Doc" Wise

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October 16, 1985

Honorable William F. Parkerson, Jr.
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Honorable Vincent F. Callahan
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Honorable R. J. Holland
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Honorable Franklin P. Hall
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Re: Proposed Revision of Interest Rate Laws

Gentlemen:

We have received a copy of Senator Parkerson's letter of October 4, 1985 to Bill Cramme requesting our response to Mr. Wise's comments set forth in his letter of September 23, 1985. As you know, we represent the Virginia Mortgage Association.

Mr. Wise's comments reflect the frustration of everyone who has had occasion to deal with the existing statutory scheme as it applies to second mortgages. While Mr. Wise's notion of a single statute regulating the making of second mortgage loans by all lenders, regardless of whether they are licensed or unlicensed, is not unappealing, my client has gathered the impression that other lenders who enjoy the freedom to charge anything agreed to in the obligation of indebtedness would object strongly to legislation imposing new limitations upon them. Thus, the Association decided to offer a proposal specific to unlicensed lenders which it feels strikes a fair balance between the need for protection of consumers against unconscionable lending practices and the legitimate interest of lenders in operating at a fair profit. Superimposed upon the potential tension between the consumers' point of view and the profit orientation of the lenders is the need to create an atmosphere in which lenders in Virginia can compete with those in other states for funds to meet the needs of a segment of the borrowing public which has difficulty in obtaining loans from depository institutions.

Within this framework of objectives, the Virginia Mortgage Association is comfortable with the notion of a cap on prepaid charges; however, the five percent maximum suggested by Mr. Wise is not sufficient to permit smaller lenders with limited capital to participate in the industry. Many lenders have the opportunity to utilize deposits as a source of funds for making loans. In contrast most of the unlicensed lenders must borrow their funds at rates substantially above the prime rate of interest and must often pay commitment fees and discount points in addition to the interest rates. Because borrowers with spotless credit histories and ready realizable equity are more likely to seek funds from the licensed lenders, the unlicensed lenders find themselves dealing with a relatively high-risk segment of the market. Frequently, purchasers in the secondary market require the payment of points to generate the yield they themselves are seeking. Another factor contributing to the cost of doing business under the provisions of Section 6.1-330.16 is the limitation on the ability of the unlicensed lender to recover out-of-pocket costs in situations where the loan is not made. The present limitation of $50.00 is clearly inadequate when one considers that appraisal fees alone often amount to $200.00 or more. Given the fact that a substantial percentage of loan applications processed by these lenders do not result in closings, bearing the cost of appraisal fees is a major operational consideration.

When considering the appropriate level at which to impose a cap upon prepaid charges, dollar amounts as well as percentages should be considered. Undoubtedly, the same effort may go into processing and closing a $10,000.00 second mortgage loan as that required to process and close a $50,000.00 first mortgage loan. Charging ten points on the $10,000.00 generates the same $1,000.00 in compensation that charging two points generates on the $50,000.00. Moreover, under the present statutory scheme, a first mortgage lender is permitted to make any charges agreed to in the obligation of indebtedness, regardless of whether those charges are prepaid or paid in installments over the life of the loan. Often the borrower with a favorable existing first mortgage is better off economically to enter into a higher rate second mortgage than to refinance a single digit first mortgage. If second mortgages are regulated so tightly that profit incentive is destroyed, it is certainly possible, if not probable, that more and more favorable first mortgages will be refinanced at significantly higher rates due to the absence of limitations upon the charges which may be made in connection with first mortgage loans.

The Association believes that the ten-point ceiling on prepaid charges it has proposed is appropriate to prevent over-reaching, while at the same time preserving a reasonable opportunity to operate profitably.

Much attention has been paid to examples of abuse in the imposition of prepaid charges. Consideration also should be given, however, to the total cost of credit in second mortgage transactions in relationship to costs likely to be incurred in other consumer transactions. The most accurate point of comparison is the calculated annual percentage rate. In credit card transactions, annual percentage rates in excess of eighteen percent per annum are commonplace. Even higher rates are available to consumer finance companies. In the area of new car sales, artificially low rates have been made possible by reduction or elimination of the opportunity of a car owner to obtain large discounts off the sticker price. In the construction and marketing of new homes, the technique of "buying down" an interest rate is frequently utilized. Surely, the cost of buying down the rate is reflected in the price of the home. Virginia has long embraced the time price doctrine which exempts contracts for the sale of goods from the usury provisions. It is arguable that money in our society has become the equivalent of goods, that is money is now bought and sold as a commodity in virtually every segment of our economy. As a philosophical matter, the proper focus may be the quality of disclosure rather than the amount being charged. If a borrower understands what he is being asked to pay, and how it is to be paid, why should that borrower not be free to choose whether he wishes or does not wish to commit himself to the transaction.

Mr. Wise has commented specifically that the proposal of the Association is somehow violative of federal truth-in-lending laws. We do not believe that to be the case. First, federal law does not regulate what may be charged; rather, it requires uniformity of disclosure of Finance Charge and Annual Percentage Rate to assure that the federally mandated disclosure statement accurately reflects the total cost of the loan to the consumer. Nothing in the Association's proposal is at odds with the federal approach to disclosure. Secondly, Virginia law is already in conflict in a limited sense with the approach under federal law to certain types of charges. For instance Virginia has long provided that the 2% service charge does not have to be taken into account in determining whether a loan is usurious. Nonetheless, Regulation Z recognizes such charges as prepaid Finance Charges which must be included in the calculated Annual Percentage Rate. Thus, the disclosed Annual Percentage in any loan where a service charge will be imposed is always higher than the stated interest rate in the borrower's note.

A second point of conflict concerns brokerage fees. Regulation Z recognizes the independent nature of a borrower's contract with a broker and does not require that a broker's fee be disclosed by the lender as a Finance Charge. In Virginia, a brokerage fee attendant to a loan made under Section 6.1-330.16 may be paid only out of the service charge or interest allowed the lender. Thus, because interest and service charge are both components of the Finance Charge, the brokerage fee ends up a part of the Finance Charge and Annual Percentage Rate indirectly. The Association's proposal attempts to make Virginia law consistent with federal law on this point.

Mr. Wise objects to the retention of add-on rates. As we discussed with the committee, the Association's proposal does not seek to change existing law regarding add-on rates.

Mr. Wise focuses on our use of the term "Periodic Interest" and correctly states that there is no such term presently. Whether the exact term "Periodic Interest" or some other term such as "Installment Interest" is used, there needs to be a means to distinguish between interest accrued over the life of the loan and prepaid interest. The Association is not wed to any particular terminology as long as the concepts are clearly stated.

Mr. Wise also suggests supervision of lenders in the second mortgage area. As a matter of principle, the Association is not opposed to this idea. We point out, however, that the regulatory framework presently in place for most licensed lenders does not involve supervision of their lending practices. We believe a comprehensive method for supervising all lenders would be costly and that the objective of achieving fairness can be accomplished through clarity in the statutes.

We appreciate the opportunity to respond to Mr. Wise's correspondence.

Alex T. Mayo, Jr., Counsel for
The Virginia Mortgage Association

cc: C. William Cramme, III, Esquire

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October 21, 1985

FILE NO.

BY HAND

C. William Cramme', III, Esquire
Staff Attorney - Commerce & Labor
Division of Legislative Services
General Assembly Building - 2nd Floor
910 Capitol Street
Richmond, Virginia 23219

Re: H.J.R. 217 - Draft of Virginia Mortgage Association Laws Relating to Second Mortgages

Dear Bill:

The comments herein relate to subsections A through G of Mr. Mayo's draft of § 6.1-330.16 tendered at the last meeting of the Commission on September 16. The various definitions appear to relate to the permission to charge points and may be commented upon under the other subsections.

B. This subsection in permitting charging of interest for any loan secured "in whole or in part" by a subordinate mortgage on residential real estate permits charges thereunder, which are not otherwise permitted by Virginia law, in the cases the subordinate mortgage is a minor part of the security given for the loan. For example, a $10,000 loan secured by $1,000 in equity of real estate would be permitted hereunder, if the lender would make the loan.

It is not clear to me whether the statute requires a truth-in-lending disclosure when none is required otherwise because of no consumer purpose under Regulation Z is set forth.

This subsection B would permit any interest rate if a truth-in-lending disclosure is made. It also clearly permits 10 points.

C. This clearly set forths that the 10 points are in no way subject to rebate upon early prepayment or acceleration. I think that was true of the 2 points otherwise permitted under § 6.1-330.16. This is confirmed by his proposed repeal of § 6.1-330.31 giving the right of prepayment.

D. This more or less follows the present statute relating to fees <u>of the lender</u> if the loan is not made.

E. This section would bless any loan heretofore made, even though the matter was currently in litigation and even though the matter otherwise violated existing law - including loans on which 30 points were charged.

F. This more or less follows present § 6.1-330.24. Subsection (iii) changed the present statute in that now the lender may require decreasing term life insurance for an amount not exceeding the loan.

Subsection (v) simply changes the existing law which provides the broker must be paid out of the amount received by the lender or the amounts otherwise permitted by the statute as interest. Now it is clear that if a loan was made at 20% plus 10 points, any amount of brokerage could be added thereon. This proposed amendment would go to the heart of the evil to which the statute was originally aimed in 1966 in which the so-called brokers in the Tidewater area, which were thought to be affiliated, were turning down loans after collecting the fee and referring them to an affiliated or friendly broker and the charge was eventually being made by the broker in addition to the minimal interest rate then permitted by law. The statutes passed in 1966 were to require the brokerage fees on second mortgages to be included within the permissible interest rate and also to limit or eliminate brokerage fee if the loan was not made.

G. At present under § 6.1-330.16, an add-on loan may not exceed 10 years and 2 months and there is no reference in § 6.1-330.16F to permissible add-on loans where the phrase "simple interest" is used. In the case of an add-on loan, there is a required rebate under the Rule of 78's, but apparently not otherwise.

H. This subsection carries forward a policy now enunciated in § 6.1-330.16 with regard to the 2% service charge permitted.

I. This conforms to present law.

J. I believe this conforms to the present rules.

The repeal of § 6.1-330.47 repeals the null and void penalty and I assume it reinstates the usury penalty.

The definition of "lender" on page 2 is peculiar in that it excludes persons enumerated in §§ 6.1-330.25 and 6.1-330.48. Then on the last paragraph these statutes would be repealed.

Sincerely yours,

Jack Edmds

John W. Edmonds, III

30/307

cc - William D. Grove, Esquire

COMMONWEALTH OF VIRGINIA

Sidney A. Bailey
Commissioner of Financial Institutions

Suite Sixteen Hunc
701 East Byrd Stre
P.O. Box 2AE
Richmond, Virginia 23205
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STATE CORPORATION COMMISSION
BUREAU OF FINANCIAL INSTITUTIONS

December 31, 1985

The Honorable George H. Heilig, Jr.
700 Newtown Road
Norfolk, Virginia 23502

Dear George:

I have appreciated your interest in my comments on the proposed changes to the Money and Interest Act which the Interest Rate Subcommittee has studied over the past several months.

Having analyzed the latest draft legislation, distributed at the December 16, 1985, meeting, I would like to place before the Subcommittee the enclosed suggestions, some of which I outlined briefly at that meeting. These changes have been discussed with the Commissioners, and they concur.

If you want me to draft language to accomplish these suggested changes or if I can aid the Subcommittee in some other way, please call me.

Very truly yours,

Sidney A. Bailey

Enclosure

cc: The Honorable William F. Parkerson, Vice Chairman
The Honorable Franklin R. Hall
The Honorable Vincent F. Callahan, Jr.
The Honorable Richard J. Holland
C. William Cramme

STUDY OF THE MONEY AND INTEREST ACT

A draft of proposed amendments to Chapter 7.2 of the Code was made available at the December 16, 1985 meeting of the Study Committee. That draft incorporates a number of proposed revisions to the Money and Interest Chapter which the Study Committee apparently intends to recommend. Aside from these proposed changes, certain additional amendments are needed, in my opinion. Among these are:

1. The practice of charging "points", as a means of increasing the yield on mortgage loans, should be prohibited. It has been argued that "points" are necessary as a device to accommodate fluctuations in interest rates in the secondary mortgage loan market. While there may be some basis for that argument, such interest rate variations are highly unlikely to create a need for more than three to five points for that purpose. In this connection, if points are to be permitted, other charges such as "administrative fees" or "service charges", which amount to disguised interest, should be prohibited. The argument that undercapitalized lenders need to impose such charges in order to provide a necessary service to the public is without merit. Authority to impose charges high enough to recover all operating costs <u>in addition to</u> a reasonable profit amounts to a "costs plus" basis of operation which should not be permitted at the expense of low-income, unsophisticated borrowers, susceptible to confusing and misleading calculations of cost of credit. A desire or attempt to operate a business without adequate capital should not be an adequate reason to impose exorbitant charges in a misleading way.

2. The existing authority in §6.1-330.16(A) should be clearly defined as permitting that rate as a <u>simple interest rate</u> only. The section now is construed by unregulated lenders as permitting an eighteen percent <u>add-on</u> rate on loans secured by subordinate mortgages. The result is unconscionable. In my opinion, add-on interest should not be permitted on any loan secured by the borrower's residence. If the rate of interest is stated in simple interest terms, the borrower has a clearer, more understandable basis for deciding whether to accept the terms offered. It should be noted that, if add-on interest is to continue to be permitted, the definition of "charge in advance" should remain in the law. It is suggested further the activities of brokers and payment for their services should be strictly and absolutely confined to separate, private arrangements between such brokers and prospective borrowers, with lenders prohibited from passing the costs of such services to borrowers.

3. Any provision for "registration" of presently unlicensed and unregulated lenders is absolutely negative in its implications. "Registration" alone, without authority to regulate and, concurrently, examine and supervise for compliance with statutory and regulatory standards would accomplish nothing of value. To the contrary, registration alone would merely provide a superficial impression of regulatory control, useful for advertising and public relations purposes, but with no substantive value. If a requirement for regulatory supervision of presently unregulated lenders is to be established, there must also be provision for the resources necessary to carry out this function. In connection with establishing a regulatory function, it should be noted that consumer complaints are not reliable as a "trigger" for examination or investigation. It seems

likely that relatively few actual abuses result in complaints, either because borrowers are not certain to whom to complain or because of apathy or even lack of awareness of abusive terms. It is reasonably certain that effective supervision can result only from a systematic process. The suggestion that copies of real estate loan settlement sheets be provided to the Bureau for review appears unworkable and of no real value, as a practical matter. The volume of paper would be substantial, requiring additional staff, with no useful information provided without established rules and enforcement authority.

4. It is understood that lenders incur certain costs in processing loan applications. Therefore, recovery of actual and reasonable costs can be justified, if the lender makes a written commitment to lend but the borrower does not consummate the transaction. Authority to recover costs should be dependent upon documentation of both actual costs incurred and a commitment to lend.

5. In general, if limits on interest are to be established, such limits should apply to types of loans, regardless of lender. Allowing different rates, terms or conditions to different lenders on identical kinds of loans implies a basis for different, or even perhaps preferential, treatment of certain kinds of lenders. I see no justification in such different treatment, where risk and other bases for interest is identical.

6. If the general treatment of interest rates by type of loan rather than by type of lender is not possible, then removal of the statutory preferential treatment of industrial loan associations is strongly urged. I am not aware of any reasonable justification for the preference now afforded those institutions.

7. Prohibition of add-on interest would result in substantial simplification of interest rates, to the clear benefit of borrowers. If total prohibition is not possible, then limiting the application of add-on rates to loans of five years or less would reduce the negative effects of this practice, while permitting such rates on the vast majority of consumer loans. Such a limit would reduce substantially the unfavorable aspects of this practice.

These comments do not include reference to changes which have been or may be proposed to the Money and Interest Act which do not affect the functions of the Bureau of Financial Institutions, directly or indirectly. Views on such changes, while possibly necessary or desirable, have been omitted intentionally as not properly of concern to the Bureau.

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December 10, 1985 FILE NO. 07586.17.001

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Hon. Franklin P. Hall
Suite One, 700 Building
Richmond, Virginia 23219

Re: Study of the Virginia
Second Mortgage Act

Gentlemen:

It is my understanding that you intend to take up the Virginia Second Mortgage Act found at § 6.1-330.16 of the Code of Virginia and related sections (the "Second Mortgage Act") at your reconvened meeting to be held on December 16. It is also my understanding that your committee is considering changing the penalty for the violation of the Second Mortgage Act from the current null and void provision found in § 6.1-330.47 to a penalty more in line with the penalty provided in § 6.1-330.46.

I represent an insurance company which in June of 1984 issued a policy of mortgage guaranty insurance (the "Policy") which, subject to the terms and conditions contained therein, purported to insure certain real estate loans made under the Second Mortgage Act as it existed at that time and currently exists. I wish to call to your attention the fact that a change in the penalty section could have the result of retroactively altering the legal framework under which my client entered into the Policy, could affect pending litigation and affect existing disputes, and, as a result, have a material effect on the risks my client may have assumed at the time the Policy was issued and at the time the loans subject to the Policy were made.

Under the terms of the Policy the insurance company has the benefit of any defense that could be raised by the borrower on a particular loan. Accordingly, if a loan is null and void under the law under which the loan was made and existing law, the loan is not insured under the Policy. The reason for the provision is to protect the subrogation rights of the insurance company in the event it pays a claim under the Policy.

Under the theory announced in the Virginia case of Town of Danville v. Pace, 66 Va. (25 Gratt.) 1 (1874), if the legislature does away with or relaxes a usury penalty, the action of the legislature will apply retroactively to contracts entered into prior to the time of the action by the legislature unless the legislature evidences a contrary intent.

At the time of the Danville case, the penalty for usury was that the loan transaction was null and void. Subsequent to the time that the Town of Danville, a corporation for these purposes, executed notes obligating itself to repay loans, the legislature passed a statute providing "that no corporation shall hereafter interpose the defense of usury in any action." The statute went on to provide that "nor shall any bond, note or debt, or contract of such corporation, be set aside, impaired or adjudged invalid by reason of anything contained in the laws prohibiting usury." Accordingly, at the time the Town of Danville borrowed the money in question it had a right to plead usury, and the penalty was null and void. Subsequently, the legislature took away the Town's right to plead usury.

In the reported case, a copy of which is attached, the Town argued that the statute could not retroactively take away its right to plead usury on a contract entered into prior to the time of the adoption of the statute. The court held that because the legislature did not evidence an intent to prohibit retroactive effect, the defense of usury was taken away, and a transaction that was void when entered into was declared to be valid.

As I mentioned, I am writing because the retroactive aspect of any change to or repeal of § 6.1-330.47 may not have been brought to the attention of the committee. Because such a change could have a material effect on existing disputes, pending litigation and the risks insured by my client, we ask that in the event the committee recommends either a change to § 6.1-330.47, or its repeal, that an amendment be added which clearly states that the new penalty provision will only apply to contracts entered into after the effective date of the change or the repeal. I have enclosed a sketch of such a provision for your consideration.

I will be in court out of town on the afternoon of December 16 and, accordingly, will not be able to attend your next meeting. Fred Palmore from my office will be able to attend and will be happy to answer any questions any of you may have.

With best wishes to each of you, I remain

Sincerely,

James C. Roberts

31:494
Enclosure
cc: C. William Cramme, III, Esquire

Section 6.1-330.47 is repealed with respect to loans secured by deeds of trust or mortgages which are recorded on or after _______________. Notwithstanding its repeal with respect to the foregoing loans, the provisions of § 6.1-330.47 shall continue to apply to loans secured by deeds of trust or mortgages which are recorded prior to _______________.

CASES

DECIDED IN THE

Supreme Court of Appeals of Virginia.

Town of Danville v. Pace—Two cases.*

March Term, 1874, Richmond.

[18 Am. Rep. 663.]

Absent, BOULDIN, J.

1. **Statute—Retroactive Operation—Usury.**†—The act of March 22, 1873, Code of 1873, ch. 57, § 36, p. 544, in reference to the defense of usury by corporations, is retroactive in its operation before the passage of the act: and this, though suit has been brought upon such contract, before its passage. And the act is not in violation of the constitution of the United States or that of Virginia.

These were two actions on the case, brought in June 1868 in the Circuit court of the town of Danville, and afterwards removed to Richmond, by James B. Pace against the town of Danville, to recover interest due upon two certificates of debt issued by said town and purchased by
2 said Pace. It appears that by *the order of the council of the town of Danville there was sold at public auction, in September 1863, $20,000 of the bonds or certificates of debt of said town, payable in ten and twenty years, and bearing interest at the rate of six per cent. per annum, payable semi-annually, and of these Pace purchased two of $3,000 each, for which he gave $12,000 in Confederate States currency. Interest was paid up to and including January 1st, 1865. In June 1873, the defendant demurred to the declarations, and pleaded non assumpsit, and, in July, offered two pleas setting up usury in the debts, which pleas were, upon the motion of the plaintiff, excluded by the court; and the defendant thereupon excepted.

There were judgments in the cases in favor of the plaintiff for the amount of the interest due prior to the institution of the suit; and the town of Danville thereupon applied to a judge of this court for a supersedeas in each of the cases, which was allowed.

Ould & Carrington, for the appellant.

F. L. Smith, Marshall and F. L. Smith, Jr., for the appellee.

Staples, J. The plaintiff in the court below, who is the defendant in error here, is the holder of four notes or certificates of indebtedness, executed by the town of Danville in 1863, amounting in the aggregate to twelve thousand dollars, and maturing ten and twenty years after date, with interest thereon, payable semi-annually. In the year 1868 the plaintiff instituted actions of trespass on the case in the Circuit court of Danville, for the recovery of the interest which had accrued upon these notes
3 from the 1st *day of January 1865, to the 1st day of January 1868. The cases were subsequently removed to the Circuit court of Richmond. At the June term 1873 of that court, the defendant, in addition to the general issue, tendered two pleas of usury in writing, which, on motion of the plaintiff, were rejected; and the defendant excepted.

After the rejection of these pleas, it was agreed by the parties that a jury should be waived, and all matters of law and of fact submitted to the court upon the facts agreed: whereupon the court rendered judgment for the plaintiff. To that judgment a writ of error was awarded by a judge of this court.

The chief, if not the only question for our determination, is the right of the town of Danville to rely upon the defence of usury in these actions. The decision of that question depends upon an act passed March 22d, 1873, and found in the Revised Code of 1873, page 544. It is in these words: "No corporation shall hereafter interpose the

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***For monographic note on Municipal Corporations, see end of case.**

†See subsection K in the analysis of the monographic *note* on "Usury" appended to Coffman & Bruffy v. Miller, 26 Gratt. 698. See also, Ewell v. Daggs, 2 Sup. Ct. Rep. 413, 108 U. S. 143, where the principal case is cited and approved upon the point embraced in the headnote.

Effect of War upon the Identity of a City.—In Dinwiddie County v. Stuart, Buchanan & Co., 28 Gratt. 551, the court says, referring to the principal case, "The bonds, the subject of the controversy, were issued by the town of Danville during the war. Judgment was given upon these bonds after the war, which was affirmed by this court. It was never suggested by court or counsel that there was any 'want of identity' between Danville during the war and Danville after the war." Citing also, Miller & Franklin v. City of Lynchburg, 20 Gratt. 330.

Statutes—Retrospective Effect.—See Price's Ex'or v. Harrison's Ex'or, 31 Gratt. 115, and *note* for a collection of the Virginia authorities upon the subject. See also, Lynchburg v. Slaughter, 75 Va. 60; Lackland v. Davenport, 84 Va. 640, 5 S. E. Rep. 540; Crabtree v. Building Ass'n, 95 Va. 677, 29 S. E. Rep. 741; Smith v. Henning, 10 W. Va. 600, where the principal case cited upon this subject is affirmed.

defence of usury in any action; nor shall any bond, note, debt or contract of such corporation be set aside, impaired or adjudged invalid by reason of anything contained in the laws prohibiting usury." It is claimed by the counsel for the defendant, that this section applies only to causes of action arising, and contracts made, after its adoption; and consequently, the notes or certificates in controversy are not embraced by its provisions. The learned counsel relies strongly upon the well settled rule, that statutes are to be construed as prospective in their operation, unless the language plainly shows the intention of the legislature that they should have a retrospective effect. In support of this view he has cited numerous authorities, which undoubtedly sustain the proposition that
4 the courts will not so construe *a statute as to give it a retrospective operation, unless there is something on the face of the enactment putting it beyond a doubt that such was the purpose of the legislature. Upon this point there can be no solid ground for controversy. The question is, whether the present enactment furnishes unmistakable evidence of the legislative purpose to give it a retroactive operation and effect.

It will be observed that the words used are very comprehensive. "No corporation shall hereafter interpose the defense of usury in any action." The words, "any action," necessarily include suits instituted before as well as after the passage of the act. There is nothing in the context to give them a more limited operation. The defense is prohibited in all cases. In order to adopt the construction insisted on by the defendant, other words must be incorporated into the body of the act so as to make it read, "no corporation shall hereafter interpose the defense of usury in any action upon a contract hereafter made." But clearly the legislature did not intend so to confine the effect of the enactment. Had such been the purpose, nothing would have been easier than to have used words appropriate to that object. If any doubt upon this point existed, it will be removed by reference to the next clause in the same section: "Nor shall any bond, note or debt, or contract of such corporation, be set aside, impaired or adjudged invalid by reason of anything contained in the laws prohibiting usury." No distinction is made between contracts entered into before and after the statute: whenever made, they shall not be adjudged invalid by reason of anything contained in the usury laws. The legislature having thus declared, in the most unequivocal terms, that no contract of a
5 corporation *shall be deemed invalid because it may be usurious, it is impossible for the courts, without the grossest perversion of language, to hold that those contracts only are meant which are entered into after the law is passed.

It must not be forgotten that the first clause of the section, already quoted, is a literal copy of a New York statute upon the same subject. The identity of language, used in both statutes, shows that the framers of our act had before them the New York law, and intended to adopt it without change or qualification. In Curtis v. Leavitt, 15 New York R. 1, a very noted case, this statute received a very careful consideration. All the judges agreed in giving it a retrospective effect, so that securities, to an amount exceeding a million of dollars, were held to be valid, though utterly void when issued, by reason of the usurious taint with which they were infected.

It is not to be supposed that the legislature incorporated into our laws an important statute of another state in entire ignorance of the interpretation given to it by the courts of that state. It must be presumed rather, that the legislature in adopting the precise phraseology, intended to adopt along with it the interpretation also.

I shall have occasion hereafter to refer to a number of cases in other states involving the constitutionality of statutes giving validity to antecedent usurious contracts. The language of some of these statutes is certainly not more comprehensive than that of our act; and yet the courts there experienced no difficulty in giving them a retrospective operation and effect. The limits assigned to this opinion will not justify any citations of these statutes. I must therefore content myself with this simple
6 reference to them, *satisfied that upon examination they will sustain the view I have taken.

The learned counsel who argued the case here for the defendant referred to the 18th section of chapter 16, Code of 1860. The learned counsel obviously did not attach much importance to this section, although it seems to have been relied upon elsewhere as decisive of the case. I do not give the exact words of the section, but it substantially provides that no new law shall be construed to repeal a former law as to any act done, or right accrued, under the former law, or in any way whatever to affect any act done, or right accrued, under the former law.

In construing this section, it is necessary to consider also the preceding one, which provides that this rule of construction shall not be adopted, if it would be inconsistent with the manifest intention of the legislature. In other words, the two sections taken together mean no more than that a new law shall not be construed to affect any right accrued under a former law, unless such is the manifest purpose of the legislature. A rule of construction which would always prevail in regard to vested rights of a civil character independently of any statutory enactment on the subject.

Now if the view already presented in regard to the statute of March 23, 1873, be correct, if that statute is plainly retroactive in its operation, and was so intended by the legislature, then the 18th section does not apply to it, because it would be inconsistent with the manifest purpose of the legislature to give it such application. To adopt any other rule would be to declare that one legislature having adopted a general statutory rule of construction, no succeeding legislature is authorized to depart from that rule.

7 *It is worthy of observation that the provisions of the 18th section were taken from the revised statutes of New York and Massachusetts. The 35th section of the New York statutes, although not identical with the language of the 18th, is substantially the same in its operation and effect. That section, the 35th, was in force long anterior to the case of Curtis v. Leavitt, and yet the Supreme court of New York did not regard it sufficient to prevent the retroactive operation of their statute in relation to the defence of usury by corporations. As already stated, the first clause of our act is a literal copy of the New York statute.

For these reasons I am satisfied that all contracts of corporations, whether entered into before or subsequent to the passage of the act in question, must be held to be comprehended by its provisions. Thus construed, is the act constitutional? This is the important question for our consideration. When this subject was first under discussion my own convictions were very decided that this legislation could not and ought not to be sustained, as applied to antecedent contracts. It seemed to me not only unjust, but contrary to the first principles of the constitution, for the legislature to attempt to divest a right accrued under existing laws; and it mattered but little whether it was a right to defeat an action or maintain it; to prevent a recovery or enforce it. And although no specific provision of the constitution could be shown expressly forbidding such legislation, it had the appearance of being repugnant to the entire spirit and scope of that instrument.

Subsequent investigation has, however, satisfied me that my own views on this
8 subject were in conflict *with the opinions of many able judges and commentators, and an imposing array of well considered cases.

The reasoning employed in these cases, though not always satisfactory, and the great weight of authority upon the subject, have at least created doubts and difficulties in my own mind which ought to be controlling in passing upon an act of the legislative department. A conscientious judge will not, in the face of a current of authorities, almost uniformly tending in the same direction, pronounce against the constitutionality of a law unless upon full examination his conviction is very clear that it is plainly repugnant to the constitution. When he finds himself opposed by a long array of distinguished names; when he sees that the wisdom of the legislature and the learning of the judiciary are against him, he ought to retrace his steps, re-examine his ground, and ascertain, if possible, whether there is not some radical defect in the process of reasoning by which he has reached his conclusion. He should be careful to inquire whether indeed he is not substituting his own preconceived opinions of what may be right and proper in the particular case, as a rule or standard for the determination of a mere question of constitutional power. It should never be forgotten that the courts cannot deny validity to an act of the legislature, because it may seem to the judges that injustice has been done or sound policy disregarded. As has been well said, the judiciary cannot run a race of opinion with the law-making power upon points of right, reason and expediency. Cooley on Con. L. 168. Such an assumption would lead to dangerous conflicts of authority, and practically result in the absorption by the judiciary of the other great departments of the government.

9 *The legislature represents the sovereign authority of the people, except so far as restrictions are enforced by the constitution in express terms or by strong implication. We look to the constitution of the state not for grants of power but for limitations. When the prohibition is not found in the language of that instrument, or in its frame work and general arrangement, there is no solid ground to pronounce the enactment void. The infraction must be clear and palpable. In the language of Judge Marshall, the question whether a law be void for its repugnancy to the constitution is at all times a question of much delicacy, which ought seldom if ever to be decided in the affirmative in a doubtful case. The opposition between the constitution and the law should be such, that the judge feels a strong and clear conviction of their incompatibility with each other. Fletcher v. Peck, 6 Cranch R. 87, 128.

Bearing these principles in mind, we are to consider whether the statute already cited is repugnant to the constitution of the United States or of the state of Virginia. Two provisions of the constitution of the United States have been invoked as prohibitive of this sort of legislation. One of these is the clause declaring that no state shall pass any ex post facto law. In answer to this, it is sufficient to say, that the phrase ex post facto law, as used in the constitution, is not applicable to civil, but only to criminal and penal laws, which impose a punishment for previous acts which were not punishable at all when committed, or not punishable to the extent or in the manner prescribed. So that ex post facto laws relate to penal and criminal proceedings which inflict punishment or forfeitures, and not to civil proceedings which affect private rights retrospectively.

10 *This doctrine has been solemnly settled by the Supreme court in numerous cases, and is now the accepted rule of construction. Calder v. Bull, 3 Dall. R. 386; Watson v. Mercer, 8 Peters R. 88, 110.

The other provision of the constitution relied upon is that which prohibits a state from passing any law impairing the obligation of a contract. It seems very clear, however, that the statute, so far from invalidating the contract, upholds and sustains it. In the case of Satterlee v. Matthewson, 2 Peters R. 380, Mr. Justice Washington, commenting upon an act of the Pennsylvania legislature to which the same objection was urged, said: "Now this law may be censured as an unwise and unjust exercise of legislative power, as retrospective in its operation, as the exercise by the legislature of judicial functions, and as creating a contract where none previously existed. All this may be admitted, but the great question which we are now considering is, does it impair the obligation of a contract? It is not easy to perceive how a law which gives validity to a void contract can be said to impair the obligation of that contract. It cannot be intended that to create a contract between the parties where none existed, and to impair one, mean the same thing."

This case, and indeed all the cases, establish the position that even though a statute may take away vested rights by reason of its retrospective operation, it cannot, for that reason merely, be treated as repugnant to any provision contained in the constitution of the United States. Charles River Bridge v. Warren Bridge, 11 Peters R. 420. In considering this question then, I think we may safely discard from our view the constitution of the United States.

The next inquiry is as to the con-
11 stitution of Virginia. *Is the statute
in contravention of any of its provisions? I do not understand the learned counsel for the defendant as contending that the act in question violates any specific provision of that instrument. His proposition is substantially, that the contract here when made was usurious and void; and there was then vested in the defendant a right so to declare it; that by the statute now under consideration, he has been deprived of this right; that a law which thus takes away a valuable and a vested right is an exercise of arbitrary power, unjust in itself, and contrary to the fundamental principles of the social compact.

Now, let it be conceded there are restrictions upon the legislative power not found expressly enumerated in the constitution; that a law may not infringe upon any specific provision of that instrument and yet it may involve so flagrant an abuse of power that it is the imperative duty of the judiciary to interpose and arrest its execution; still it must be also conceded that when we depart from the express limitations of the constitution, and venture into the vast and unexplored region of implied restrictions, the legislative usurpation ought to be very clear, palpable and oppressive to justify the interposition of the judiciary. All admit that it is not competent for the legislature by retroactive laws to interfere with vested rights. But the inquiry still recurs, what are these vested rights that are secure against legislative invasion; that the legislature has the constitutional power to pass retrospective laws, laws affecting vested rights, no one will deny who is familiar with the jurisprudence of the country. According to Chancellor Kent, statutes which go to confirm existing rights
and in furtherance of the remedy, by
12 curing defects *and adding to the
means of enforcing existing obligations, have been held clearly valid, when just and reasonable, and conducive to the general welfare, even though they might in some degree infringe upon vested rights. 1 Kent's Com., page 456; Underwood v. Lilly, 10 Serg. & Rawle 101; Tate v. Stooltzfoos, 16 id. 35; Bleakney v. F. and M. Bank, 17 id. 64; Hepburn v. Curts, 7 Watts R. 300; Foster v. Essex Bank, 16 Mass. R. 245; Oriental Bank v. Freeze, 18 Maine R. 109; Townsend, v. Townsend, Peck (Tenn.) R. 1; Bell v. Perkins, Peck's R. 266; State v. Bermudez, 12 Louis. R. 352; Syracuse City Bank v. Davis, 16 Barb. R. 188; Rich v. Flanders, 39 N. Hamp. R. 304; Schenley v. Commonwealth, 36 Penn. State R. 29; Goshen v. Stonington, 4 Conn. R. 209; Wilkinson v. Leland, 2 Peters R. 627; Langdon v. Strong, 2 Verm. R. 234; Watson v. Mercer, 8 Peters R. 88.

In his work on constitutional limitation, Judge Cooley enumerates a number of retrospective statutes, the constitutionality of which is almost universally conceded. Among these are statutes validating antecedent illegal marriages, confirming city ordinances which had failed to take effect for want of registration, and by reason of such confirmation establishing liens for tax assessment upon private property, statutes abolishing penalties and forfeitures, and taking away rights of appeal in pending cases; all of which, in a greater or less degree, interfere with vested rights. After citing these and other illustrations of retrospective laws, the author proceeds as follows: "On the same principle legislative acts validating invalid contracts have been sustained, when these acts go no farther than to bind a party by a contract which he has attempted to enter into, but which
was invalid by reason of some personal
13 inability on his part to make *it, or
through neglect of some legal formality, or in consequence of some ingredient in the contract forbidden by law, the question which they suggest is one of policy and not of constitutional power." Cooley, 373-'4.

In support of this view the learned author mentions a number of cases, some of which I shall have occasion to consider in the course of this opinion. One of the most important of these is the case of Curtis v. Leavitt, 15 New York R. 1, heretofore mentioned in another connection, justly celebrated, not only for the variety and importance of the questions involved and the magnitude of the subject of controversy, but for the vast ability and learning employed in the discussion by both bench and bar. Mr. Justice Page said p. 229: "The defence of usury is in the nature of a penalty or forfeiture, and may at any time be taken away by the legislature in respect to previous as well as subsequent contracts, without trenching upon any vested rights.

A proposition that a party can have a vested right in enforcing a penalty or forfeiture, against which it is the office of a court of equity to relieve, is a legal solecism. Statutes of usury are highly penal in their character, and the defence of usury has always been regarded as an unconscientious defence, and has never received the favor of either courts of law or equity." All the judges sitting, seven in number, concurred substantially in this view. Among these were Judges Selden and Comstock, universally respected for their soundness of judgment and the extent and variety of their legal attainments. The former said: "Usury being a mere statutory defence, not founded upon any common law right, either legal or equitable, it was clearly within the power of the legislature to take it
14 away." See also Washburne *v.
Franklin, 13 Abbott Prac. R. 140, and 35 Barb. R. 599.

The decisions of the Ohio courts are in entire harmony with those of New York. I do not deem it necessary, however, to do more than make a brief reference to the case of Lewis, trustee v. McElvin, 16 Ohio R. 347, 599. It seems that the Mechanics and Traders Bank of Cincinnati was an unauthorized banking company, and all bills and notes made for the purpose of being discounted there were declared to be unlawful and utterly void. The bank transferred all its assets to a trustee, including notes discounted there in violation of law. The legislature of Ohio passed an act authorizing the trustee to institute suit upon these notes in his own name against the debtors; and it was farther provided it should not be lawful for the debtors to set up in their defence that these notes were void on account of being in violation of any statute law of the state, or on account of their being contrary to public policy. It was objected that this legislation was unconstitutional, inasmuch as the effect would be to give validity to contracts illegal and void under laws in force when they were made. Hitchcock, J. speaking for the court said: "I can never consent to declare an act of the legislature void on account of violating the constitution, unless it is palpably both against the letter and spirit of that instrument. So long as there is the least doubt upon the subject the law must be enforced. Now what provision of the constitution of Ohio is violated by this law? Certainly it violates no contract. Its very object is, that the contract may be enforced. But it is said to be a law retrospective in its character. I find nothing in the constitution prohibiting retrospective laws.
15 The enactment *of ex post facto laws
is prohibited, not retrospective. Such laws may be impolitic, but with this as a judge I have nothing to do. This law interferes with no vested rights. It merely compels men to do justice."

The case of Parmelee v. Lawrence, decided by the Supreme court of Illinois, and reported in 48 Illinois R. 331, the case of Andrews v. Russell, 7 Blackf. R. 474, decided by the Supreme court of Indiana, and the case of Woodruff v. Scruggs, 27 Arkansas R. 26, all involved the constitutionality of statutes giving validity to antecedent usurious contracts. In each case the enactment was strongly assailed as trenching upon vested rights, and in each case its validity was fully sustained by the court.

The decisions of the Maryland courts accord with those already cited. Baugher v. Nelson, 9 Gill's R. 299, is an example. In that case the point was made that the contract was void for usury, and there was vested in the defendant a right so to declare it. Mr. Justice Martin, in answering this objection, said: "When vested rights are spoken of by the courts as being guarded against legislative interference, they mean those rights to which a party may adhere, and upon which he may insist without violating any principles of sound morality. In the language of Judge Duncan, in Satterlee v. Matthewson, 16 Serg. & Rawle 191, there can be no vested right to do wrong. In the nature of things there can be no vested right to violate a moral duty, or to resist the performance of a moral obligation." See also Nelson v. Hardesty, 1 Mary. Ch. R. 56.

The Connecticut decisions proceed upon the same ground. In Goshen v. Stonington, 4 Conn. R. 209, Hosmer, C. J. in commenting upon a statute prohibiting
16 *the defense of usury as against an-
tecedent contracts, said: "It was no violation of the constitution; it was not a novelty, such exercises of power having been frequent, and the subject of universal acquiescence; and no injustice can arise from having given legal efficacy to voluntary engagements, and from accompanying them with the consequences they always import.

These questions, and others of a like character, have been perhaps more carefully considered and oftener decided by the courts of Pennsylvania than in any other state. In a long train of decisions pronounced by the ablest jurists of that state, legislation of this kind has been fully sustained as in entire conformity with both federal and state constitutions. I refer particularly to the cases of Hess v. Werts, 4 Serg. & Rawle 356; Satterlee v. Matthewson, 16 Serg. & Rawle 169; Bleakney et als. v. Farmers & Mec. Bank of Greencastle, 17 Serg. & Rawle 64.

To these cases may be added decisions of the Supreme courts of New Jersey, Michigan and Iowa. These decisions do not involve the precise points arising in the present case; but the principles they announce apply to the statute in question, and fully sustain its contstiutionality. State v. City of Newark, 3 Dutcher's R. 186; Gibson v. Hibbard, 13 Michigan R. 215; Harris v. Rutledge, 19 Iowa R. 389; State v. Squires, 26 Id. 340.

It thus appears that the constitutionality of this legislation, or legislation of a like character, has been affirmed by learned judges and commentators, by the Supreme

courts of ten states, and the declared will of ten legislatures, besides that of Virginia. Against this formidable array of authorities what have we? The learned counsel
17 for the defendant has *cited a number of cases supposed to give countenance to his position; but it will be found upon a careful examination that very few of them have any direct bearing upon the point in controversy here. The New York decisions referred to, relate principally to statutes affecting the vested rights of husbands in the estates of their wives. They do not in the least conflict with the doctrines laid down in Curtis v. Leavitt.

The cases in the Supreme court of the United States do not touch the point under consideration. The only province of that court is to enquire whether the statute is in conformity with the constitution of the United States. If it is, that court will not pronounce against its validity, because it is repugnant to the constitution of the state.

The cases from Massachusetts and Mississippi upon which so much reliance is placed, were decided upon statutes which attempted to revive certain causes of action already barred by limitation. Legislation of this kind has been generally considered an unconstitutional interference with vested rights. The reason is apparent and is well understood. The statutes of limitation are essentially statutes of repose; they are founded upon the idea that the party affected has had full opportunity to try his right: that he has lost it by his own conduct, and he has thus vested in his adversary a right of property as complete and perfect as if bestowed by grant. It has been very justly observed, that after the bar is complete, parties are justified in forbearing to take and preserve evidence, and to retain proofs and vouchers, as they otherwise would; and they feel and act upon the conviction that the cause of action is at an end. "The act of limitations is therefore a law of presumptions: it presumes evidence from length of time which cannot now be
18 produced; payments *which cannot now be proved; releases which cannot now be shown." Barton lessee v. Shall, Peck R. 215; Wright v. Oakley, 5 Metc. R. 410.

These considerations are sufficient to show that the principles which apply to rights vested by reason of the operation of the statutory limitation have no just application to laws giving effect to the contract of parties affected by the taint of usury. We are told, however, that the laws in force when and where the contract is made enter into and constitute a part of it, and consequently the legislature is not authorized so to change or modify those laws as to affect rights vested under them. This is a very just principle in some cases. But it does not admit of universal application. No one seriously maintains that the statutes of limitation in force when a contract is made, or the laws authorizing imprisonment for debt or distress for rent, constitute a part of the contract. And yet they confer important rights, and it is fairly to be presumed, in many cases, parties contract with reference to them. They are, however, often changed and even abolished at the pleasure of the legislature, without a question of the constitutional power to affect existing causes of action.

The cases decided by the Supreme court of the United States to which reference has been made, only affirm the doctrine that the laws in existence when a contract is made so far enter into and become a part of it that they cannot be changed or abolished to the extent of depriving a party of all remedy to enforce the contract. This is a well established principle, universally recognized by the courts. It proceeds upon the obvious ground that to take away the remedy entirely is, in effect, to impair the obligation of the contract. To impair
19 the obligation of a contract is *one thing; to afford a remedy for enforcing it, where none previously existed, is another and very different thing. In Sedgwick's Treatise on Constitutional Law, page 406, it is laid down that the legislature is competent to give a statute a retrospective operation unless it violates that provision of the federal constitution relating to ex post facto laws and the obligation of contracts, or unless it is repugnant to some express provision of the state constitution, or unless it interferes with vested rights of property, so as not to come within the proper limits of the law-making power. Independently of these exceptions, retrospective laws are within the scope of the legislative authority, and the judiciary will not interfere with them. Now, it is very clear that statutes taking away the defense of usury as against antecedent contracts are not included in either of the exceptions mentioned. As has already been seen, they do not infringe upon the federal constitution, they certainly do not violate any express provision of the state constitution, and it is equally clear they do not interfere with any vested right of property.

The usury laws are founded upon considerations of public policy. They are modified from time to time, and even abolished, as the popular sentiment may dictate, or the public interest require. In Virginia, these laws have undergone frequent changes in the last few years. In other states, parties are left free to regulate the subject at their discretion, with a statute fixing the rate of interest in the absence of any express agreement. If no laws upon the subject existed, no one questions that any rate agreed upon by the parties would be lawful and enforced by the courts. The statutes upon this subject are regarded as
20 purely remedial, and subject *to the modification and control of the legislative department, even as applied to past transactions. This is the view of the courts and legislatures, not only in modern times, but seems also to have prevailed in the earlier history of the state. By the act of 17[illegible], usurious contracts made previous to the [illegible]

of November, 1734, were legalized to the point of principal and lawful extent. We have no means of ascertaining whether the constitutionality of this statute was ever called in question. The presumption is that it was not, as the legislature fourteen years after, in 1748, re-enacted identically the same provision.

Now it is very clear that the contract being an entire thing, the promise of the debtor to pay the principal and lawful interest cannot be separated from the promise to pay the usurious premium. In either case the promise is utterly void. If, therefore, the legislature may legalize the contract as to the principal and lawful interest, it may legalize it as to the excess. If it may take away the defense of usury as to part, it may do so as to the entire contract. Courts of equity effect substantially the same results contemplated by these early statutes, in requiring the payment of the principal and lawful interest as a condition of relief; and this too in direct opposition to the statute forfeiting the entire debt. Indeed the charge is sometimes made that the equity courts repeal the statutes prohibiting usury. May not the law-making power apply the same rule to the common law courts; may it not clothe these courts with like jurisdiction and authority to administer relief in the mode exercised by the equity courts? If indeed it may prescribe that the defense of usury shall be
21 taken away as to *the principal and lawful interest, it may declare that the defense shall not be made at all.

Under one section of the statute prohibiting usury, if the borrower exhibits his bill and calls for discovery, he is relieved upon the payment of the principal without interest. If he does not seek a discovery, but asks for an injunction to prevent a sale of property, and is full-handed with proof, he is released from the payment of both principal and interest. There can be no question, I imagine, but that this relief may be varied at the pleasure of the legislature, and that it may be applied alike to antecedent and to subsequent transactions. The statutes against usury are regarded in Virginia as highly penal in their character. In Brockenbrough's ex'ors v. Spindle's adm'ors, 17 Gratt. 21, 32, the president of this court said: "However small the amount of usurious interest contracted for, and however large the amount of money loaned, the contract is declared void, and the lender forfeits the whole amount of the debt and interest."

In Crenshaw's adm'or v. Clark, 5 Leigh 65, 72, Judge Carr speaks of the loss of the debt as a severe penalty, not to be inflicted without clear and strong proof. And in the same case Judge Tucker said: "The defense goes not merely to absolve the debtor from usurious gain, but to vacate the contract and to annihilate the debt, to take from the usurer his just principal and interest, and put it in the coffers of the debtor to whom it does not fairly belong."

These citations sufficiently show the light in which the defense of usury has been regarded in Virginia, and that the loss of the debt under that defense is treated as a forfeiture imposed by the stern mandates of the statute.

22 *There may be cases, but I have not seen them—certainly no well considered case—in which it has been held that a party can have a vested right to a forfeiture, contrary to the express terms of the contract, even where the forfeiture results from a violation of an agreement. Courts of equity often relieve against it upon the application of the debtor. This is a favorite branch of equitable jurisdiction. It is founded upon the idea that although the legal right to the forfeiture is complete, the creditor shall not be permitted to avail himself of it for the purposes of injustice and oppression. This is certainly an interference with vested rights; but they are not of such a character as are deemed secure against legislative or judicial action. In the language of the Supreme Court of New Jersey, "Courts do not regard rights as vested contrary to the justice and equity of the case."

In the case of Foster and others v. Essex Bank, 16 Mass. R. 245, it was urged that a statute giving a right of action against certain debtors, which had been lost by the expiration of the bank charter, was retrospective and void. Parker, J., said: "The statute does not interfere with any of the privileges secured by the charter, unless it be considered a privilege to be secured from the payment of debts or the performance of contracts; and this is a kind of privilege which we imagine the constitution was not intended to secure. The truth is, there is no such thing as a vested right to do wrong."

Unless we suppose it is the deliberate purpose of the debtor when he borrows the money never to return it, the only effect of the statute is to compel him to do what he intended and agreed to do at the time of entering into the contract. It is a legislative declaration that the forfeiture shall not be enforced. It leaves the
23 *contract to be executed according to its terms and the original intention of the parties. It violates no vested right, unless it can be considered a vested right of the loaner to vacate his contract and annihilate his debt. Clearly this is not the kind of right the constitution was designed to protect.

This conclusion would not be varied in the slightest degree by the passage of the legislative act after the institution of the suit. It might be argued, with some degree of plausibility, that the plaintiff, having brought his suit, thereby acquires rights which cannot be affected by subsequent legislation; but it is difficult to perceive in what way an action against a party can confer upon him rights he did not possess independently of such action. If the right to rely upon the defense of usury is not in the nature of a vested constitutional right, secure against legislative invasion, the law-making power may certainly take away the privilege at any time before its actual exercise by the defendant.

Upon this point the authorities are abundant and generally uniform. I do not deem it necessary to do more than refer to a few of the most important. Butler v. Palmer, 1 Hill's R. 324, 330; Stoever v. Immell, 1 Watts' R. 258; Curtis v. Leavitt, 15 New York R. 1; Satterlee v. Matthewson, 16 Serg. & Rawle R. 169; Sedgwick on Con. Law 412.

It has been very strongly argued that this law involves the exercise of judicial functions by the legislature. This objection was suggested in some of the cases heretofore mentioned. In others it was not even alluded to. In none of them does it seem to have received much attention, or to have been considered as entitled to much weight.
The case of Griffin's ex'or v. Cun-
24 ningham, 20 Gratt. *31, is, however,
principally relied on in support of the objection. In that case a majority of this court held that an act of the legislature authorizing a review, after the term was ended, of the decrees and judgments rendered by the Court of Appeals, which sat here before the organization of the present government, was in the nature of a judicial act, and was therefore void. This decision was based upon the obvious ground, that a statute which vacates decrees and judgments, grants new trials, or authorizes rehearings, is essentially judicial in its character. Such an act is the very essence of judicial power, and an invasion of the judicial department.

This simple statement demonstrates that the reasoning advanced, and the doctrines asserted in Griffin v. Cunningham, have no application to the subject under consideration. It is proper to add, that two of the judges, Moncure and Anderson, did not concur with the majority in that case. They were of opinion that the statute was in every view constitutional and valid.

All will concede that the line which separates judicial from legislative functions, is, in many cases, shadowy and indistinct, so that it is often a matter of real difficulty to determine within which of the two classes a particular subject falls.

Statutes affecting limitation of actions, statutes relating to frauds and perjuries, to the admission of parol and written evidence, statutes relating to the registration of deeds, legalizing judicial proceedings, validating defective marriages, and a multitude of others, apply to the transactions and agreements of parties rules of decision wholly different from that which prevailed when the transactions occurred or the agreement
was made. And yet these statutes
25 have *been fully sustained as clearly
within the constitutional competency of the law-making department.

The courts of Pennsylvania decided that the relation of landlord and tenant could not exist in that state under a Connecticut title. The legislature of that state then passed an act which provided that such relation shall exist and be effectual on the trial of cases then pending or thereafter instituted. This act was fully sustained by both state and federal courts, and was actually applied to suits or a suit brought before its enactment. Judge Cooley expresses the opinion, that as the purpose and intent of the act was to remove from contracts which parties had made, a legal impediment to their enforcement, there would seem to be no doubt, in the light of the authorities, that the conclusion reached was the only just and proper one. Satterlee v. Matthewson, 16 Serg. & Rawle 169.

That case goes much farther than is necessary for the purposes of this. There the statute was intended to apply only to a few cases; here it is general in its character—applicable to all the contracts of corporations made before or after the date of the act. A law which prescribes a general rule for the adjudication of all contracts of a certain character, may, in its retrospective feature, affect vested rights; but clearly it does not involve the exercise of judicial functions.

It only remains to consider, very briefly, one other objection urged by the learned counsel for the defendant. It is said that the law does gross injustice to the defendant. I must confess it does not so appear to me. None of those considerations which prompt the legislature to interpose for the security of the needy debtor against the exactions of the usurer apply to corporations.
As a general rule, they sell their bonds
26 *in the public market, for the best
price such securities will command. In such case there is no demand for an usurious premium, and no intention to commit usury; but a fair contract of purchase and sale upon terms believed by both parties to be just and legal. Such securities are often sought for as safe, judicious and permanent investments, under the sanction of the courts. In this way the resources and means of the corporate authorities are increased, the burdens of excessive taxation avoided, and the health, the comfort and prosperity of the inhabitants of towns and cities promoted and extended by the establishment of useful institutions, valuable works of public improvement and the blessings of good government. These considerations are sufficient to show that the defense of usury by corporate bodies is not in accordance with the dictates of justice or an enlightened public policy. The legislature might, therefore, well provide that no such defense should be interposed in any action against them. The constitutional power being conceded, there is no valid reason why the prohibition should not extend alike to antecedent and subsequent contracts. But if I am mistaken in this view, it is very clear that the injustice or impolicy of a law is not a matter for judicial consideration. In no case can the sanctity, the honesty and the wisdom of the legislature become questions of judicial cognizance. We must take the law as we find it. We must treat it as having been deliberately

considered by the legislature; all its provisions, as it respects their constitutionality and expediency, thoroughly examined and understood, and finally receiving the enlightened approval of the executive.

27 Thus regarding it, we can *arrest the execution of the law only upon a clear conviction that the legislature has transcended its constitutional limits in the enactment. Entertaining no such conviction in this case, we are constrained to affirm the judgment of the Circuit court.

The other judges concurred in the opinion of Staples, J.

Judgment affirmed.

MUNICIPAL CORPORATIONS.

I. DEFINITION AND CREATION.

A municipal corporation, in its strict and proper sense, is the body politic and corporate constituted by the incorporation of the inhabitants of a city or town for the purposes of local government thereof. 1 Dillon's Municipal Corp. (4th Ed.) § 19.

In Virginia and West Virginia, municipal corporations are created and organized only under special legislative enactments, which constitute their charters. 15 Am. & Eng. Enc. Law 959.

In Brown v. Gates, Treasurer, etc., 15 W. Va. 131, it was held that the city government, is not the corporation.

"City"—Construction of Statutes.—In Roche v. Jones, 87 Va. 484, 12 S. E. Rep. 965, section 1016, Va. Code 1887, is held not to apply to a town having less than 5,000 inhabitants, and no corporation court, notwithstanding Code, § 5, ch. 16, provides that the word "city" shall be construed to mean a town of 5,000 population and a corporation court.

II. RIGHTS AND POWERS.

A. In General.—A municipal corporation has only such powers as are conferred upon it, by the legislature, in its charter; or more specifically, as said by the court in Duncan v. City of Lynchburg, 98 Va. —, 34 S. E. Rep. 964: "It is the settled law of this state that a municipal corporation possesses and can exercise the following powers, and none others: first, those granted in express words; second, those necessarily or fairly implied, or incident to the powers expressly granted; third, those essential to the declared objects and purposes of the corporation,—not simply convenient, but indispensable." See also, Lynchburg, etc., Co. v. Dameron, 95 Va. 545, 28 S. E. Rep. 951; Wallace v. Richmond, 94 Va. 204, 26 S. E. Rep. 586; Winchester v. Redmond, 93 Va. 711, 25 S. E. Rep. 1001; Whiting v. West Point, 88 Va. 905, 14 S. E. Rep. 698; Roper v. McWhorter, 77 Va. 214; Danville v. Shelton, 76 Va. 325; Charleston v. Reed, 27 W. Va. 681; Peters v. City of Lynchburg, 76 Va. 927; Kirkham v. Russell, 76 Va. 956.

As said by the court in Ould v. City of Richmond, 23 Gratt. 467: "The powers of public corporations are either express, implied, or incidental. And except as to such powers as are incidental, the charter itself, or the general law under which they exist, is the measure of the authority to be exercised. They have no inherent jurisdiction, like the state, to make laws, or adopt regulations of government. They are governments of enumerated powers, acting by a delegated authority; so that while the state legislature may exercise such powers of government, within the description of legislative power, as are not expressly or impliedly prohibited, the local authorities can exercise those only which are expressly or impliedly conferred, and such as are incidental, subject to such regulations and restrictions as are annexed to the grant."

The exercise of chartered functions in a mode different from that prescribed is a want of power on the subject. Page v. Belvin, 88 Va. 985, 14 S. E. Rep. 843.

Contracts—Limited Powers—Acts Ultra Vires.—All persons contracting with a municipal corporation must, at their peril, inquire into the power of the corporation or its officers to make the contract. A contract beyond the scope of the corporate powers is void. City of Winchester v. Redmond, 93 Va. 711, 25 S. E. Rep. 1001.

Grant of Franchise to Street-Car Company—Validity—Constitutional Law.—Under the general statute law of West Virginia governing cities and towns, a grant by a municipal corporation of the privilege, not exclusive, of occupying its streets for the conveyance of electricity for public use therein, confers a valid franchise, and is a contract protected by the provisions in state and federal constitutions prohibiting the passage of any law impairing the obligations of contracts. (The question of the reasonableness of the term of such grant not considered.) Clarksburg Electric Light Co. v. City of Clarksburg *et al.* (W. Va.), 35 S. E. Rep. 994.

Grant of Exclusive Franchise—Validity.—The council of the town of Clarksburg in 1887 had no power, either under its charter or under the general statute law governing towns and cities, to grant an exclusive franchise for 20 years to a private corpo-

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FILE NO.

January 8, 1986

The Honorable George H. Heilig, Jr.
House of Delegates
General Assembly Building
910 Capitol Street
Richmond, Virginia 23219

Re: HJR 217 - Definition of "bank", "savings and loan association" and "credit union"

Dear George:

I enclose letter to Walter Ayers, stating a possible objection to defining "bank" or "savings and loan association" or "credit union" as including such institutions of the other 49 states.

Any definition has to include in-state banks, savings and loans, and credit unions, in the first case, both national and state banks, and in the second case, both federal and state savings and loan associations. Federal credit unions are not included because they are controlled by a separate federal statute as to what they may charge.

I think the statute also has to include those foreign, mutual savings and loans and credit unions (all credit unions) which have merged into them, a Virginia association or credit union, which foreign institution continues to do business in Virginia.

The statute is simpliest and clearest if it covers each bank chartered and located in each of the 50 states, each such savings and loan association, and each such state credit union.

I am primarily thinking probably the second mortgage situation by giving foreign lenders regulated in foreign states, but not in Virginia, access to unlimited Virginia statutes. I pose the question if this is desirable and whether we might have regrets if only one or two foreign savings and loan associations or foreign credit unions or foreign banks took advantage of this.

I would point out that there is a possibility of this under the first mortgage statute, § 6.1-330.37, and the only alleged abuse has been by in-state lenders, including Landbank Equity.

Nevertheless, I did want to point this out to you and suggest that it be pointed out to either the full Subcommittee and/or to the legislative committees to which the bill will go.

Sincerely yours,

John W. Edmonds, III

30/471

cc: Mr. Walter C. Ayers
C. William Cramme', Esquire

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December 31, 1985   FILE NO.

Mr. Walter C. Ayers
Executive Vice President
Virginia Bankers Association
700 Building - 14th Floor
7th and Main Streets
Richmond, Virginia 23219

Re: HJR 217 - Definition of banks, savings and loan associations and credit unions

Dear Walter:

I do want to lay out for your concern and concern of the carbon copy addressees the implications of what we did in defining banks, savings and loan associations, and credit unions in the interest laws to have nationwide definitions. Maybe I am having second thoughts. I think what I want to do is make the point to the Subcommittee that is discussed hereunder (3).

(1) There is no doubt that the words banks, savings and loan associations, and credit unions have described and should continue to describe banks, savings and loan associations, and credit unions organized under Virginia law and national banks and federal savings and loan associations with their primary place in Virginia.

(2) There is no doubt that it should encompass foreign savings and loan association both state and federal and credit unions under other states, which have merged into Virginia organizations with the foreign organization being the surviving entity which has branches or offices in Virginia.

(3) The third category would be banks, savings and loan associations, and credit unions which have no office in Virginia and yet make loans in Virginia. Should they have the benefits of Virginia law? We have previously had the anomaly of a Maryland savings and loan association making second mortgage loans under Virginia law and probably not being a savings and loan for purposes of Virginia law, but being under the second mortgage act only if it is a state association and not a federal association, a peculiar result.

My apprehension is that the foreign bank, savings and loan association, or credit unions having no office in Virginia might utilize one of the no limit statutes for the purpose of charging interest in Virginia under the no limit statutes designed to apply to institutions which are regulated in Virginia. Without casting dirty water, say for example a Pennsylvania savings and loan association, charging substantially above market. We have had this situation on first mortgage loans since about 1970. I point out that the first mortgage section, § 6.1-330.37, is not limited to these regulated institutions but applies to any lender. At least I have not heard of any abuse by these out-of-state lenders in this area. (I have heard of abuse by state lenders, basically the same persons who were abusing the second mortgage statute).

Sincerely yours,

John W. Edmonds, III

30/471

cc: Mr. Mark W. Saurs
Mr. S. Miles Dumville
Mr. Reginald N. Jones

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FILE NO.

September 18, 1985

C. William Cramme', III, Esquire
Staff Attorney
Division of Legislative Services
General Assembly Building
910 Capitol Street
Richmond, Virginia 23219

Re: HJR 217 - Definitions in Chapter on Interest

Dear Bill:

I would suggest that the words "bank", "savings and loan" and "credit union" be defined so as to include or exclude banks, savings and loans and credit unions located outside of Virginia.

This comes up not only in the statutes such as present § 6.1-330.13, § 6.1-330.14, § 6.1-330.18 and § 6.1-330.44 but also under § 6.1-330.25 and § 6.1-330.48 (which may disappear) relating to second mortgages. The latter two relate to state (Virginia and non-Virginia) banks, savings and loans and credit unions and run into a different problem in that out-of-state institutions are not regulated by the State Corporation Commission, yet. They could in the case of a savings and loan association under the 1985 legislation which might merge a Virginia association into it.

I would suggest that the statute could say:

> "Bank" means any national bank located in Virginia and a bank organized under Chapter 2 of this Title, and shall not include national banks located outside of Virginia or banks incorporated and organized under the laws of another state.
>
> or
>
> "Bank" shall include a national bank, any bank organized under the laws of Virginia, or the laws of any other state of the United States which is eligible for FDIC insurance.

I believe the same approach could be taken with regard to savings and loan associations.

I believe that credit unions have their own federal statute or regulation of 21% which probably preempts state law. See 12 U.S.C. § 1757. There doesn't seem to be any decision in the U. S. Code Annotated relating to preemption, but it appears to me to be preemptive. You may want to check with Reggie Jones on this. What I am suggesting is that interest to credit unions probably should relate only to state credit unions (Virginia and non-Virginia) and not include federal credit unions - because it can't.

I will note the inconsistency that this does not bother me. If a Virginia credit union cannot come under present § 6.1-330.16 while a foreign credit union does, this is also true of banks in other states and savings and loans in other states. National banks would seem to come under this by virtue of 12 U.S.C. § 85 and the most favored lender doctrine, as would Virginia banks and Virginia savings and loans with a comparable state section and a comparable Federal section in case of banks.

Sincerely yours,

Jen

John W. Edmonds, III

30/471

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September 25, 1984 FILE NO.

Reginald N. Jones, Esquire
6722 Patterson Avenue
Richmond, Virginia 23226

Mr. Mark W. Saurs, President
Virginia Savings & Loan League
Imperial Building, Suite A
5th & Franklin Streets
Richmond, Virginia 23219

Re: <u>HJR 30 Interest</u>

Gentlemen:

I enclose preliminary draft of statute defining "depository institution" for the purpose of the interest statutes.

I am not wed to the term "depository institution" if anyone has a different phrase. I am reluctant to use the term "financial institution" as defined in Section 6.1-2.1. It is found in other sections in the Title including Section 6.1-2.7, Section 6.1-2.9, Section 6.1-2.9:1, Section 6.1-2.9:2 and Section 6.1-2.9:3. Since industrial loan associations and consumer finance companies cannot accept deposits and permit checks to be drawn thereon, the definition in Section 6.1-2.9:2 is probably limited to my definition of "depository institution". Nevertheless, if we were to modify the definition of "financial institution" in Section 6.1-2.1 we would be amending the other enumerated statutes and probably some other statutes contained in Title 6.1 which I do not have ready reference. If Bill Cramme' has great faith in his computer, he may be able to spot these other sections.

I am limiting the definition of "depository institution" or any other substantive phrase we devise to Chapter 7.2 because I am apprehensive this phrase is found elsewhere in Title 6.1 and perhaps elsewhere in the Code.

You will also note that any definition for the purpose of Chapter 7.2 is very much tied into the interstate banking issue,

Reginald N. Jones, Esquire
Mr. Mark W. Saurs
September 25, 1984
Page 2

unless the Committee wants to expand the definitions of interest and usury sections to apply to banks, savings and loan, and credit unions no matter where incorporated or located if they make loans in Virginia.

Since the present drafts limit interstate banks to holding company acquisitions, I don't believe we have to salute the foreign bank business in Virginia. Under both the savings and loan draft and last year's credit union bill (which I understand is this year's approach) it would be necessary to salute the foreign savings and loan association or foreign credit union doing business in Virginia. If this foreign institution is a state institution it should have to qualify under Title 13.1 which gives me an animal to which to direct the language. The federal animal would not qualify. Inasmuch as the federal credit unionhas a 21% statute, they may not care as much, but Reggie would have to be the judge of this. A federal savings and loan association probably could be addressed by the device to limit it to those having an office in Virginia. In any event, the federal savings and loan association has the benefit of present Section 6.1-330.37 relating to first mortgage loans. The more perplexing question would be the loan secured by a savings account, the second mortgage loan, and the ordinary consumer loans.

I would appreciate your comments.

I could have gone into a more sophisticated and historic definition of a depository institution being one that took checking or savings accounts from the public but my feeling is that the enumeration as set forth in my draft is the preferable approach.

Sincerely yours,

Jack

John W. Edmonds, III

30/471
Enclosure
cc: C. William Cramme', Esq.
Mr. Walter C. Ayers

§ 6.1-330.__. "Depository Institution" defined. The "depository institution" as used in this Chapter shall include a national bank with its main office located in Virginia, a state bank incorporated under the provisions of Chapter 2 of this Title, a federal savings and loan association with a main office in Virginia, a state savings and loan association incorporated under Chapter 13.1, a savings institution authorized to do business in Virginia as a foreign corporation, a federal credit union, a credit union organized under the provisions of Chapter 4, and a credit union incorporated under the laws of another state authorized to do business in Virginia as a foreign corporation. The term "depository institution" also includes any subsidiary of such an institution.

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May 20, 1985

FILE NO.

C. William Cramme', III, Esquire
Staff Attorney
Division of Legislative Services
General Assembly Building
910 Capitol Street
Richmond, Virginia 23219

Re: HJR 217

Dear Bill:

I enclose copy of the opinion of the Attorney General of April 10, 1985, relative to the words "bank" and "savings and loan" as used in subordinate mortgage statutes. I would point out that the problem of definitions also occurs in §§ 6.1-330.13:1, 6.1-330.14, 6.1-330.19:1, 6.1-330.44, and other statutes.

Section 6.1-330.44 may be a little more difficult to attack from the point of view of Chapter 7.2 in that the definition of "financial institution" goes back to § 6.1-2.1 which uses the word "bank" and "savings and loan association" wihtout further definition. In that latter statute by virtue of the scope of the statute it is almost inherently limited to Virginia banks and savings and loan associations.

Sincerely yours,

John W. Edmonds, III

30/471

COMMONWEALTH *of* VIRGINIA

Office of the Attorney General

Gerald L. Baliles
Attorney General

William G. Broaddus
Chief Deputy Attorney General

Donald C. J. Gehring
Deputy Attorney General
Criminal Law Enforcement Division

Maston T. Jacks
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Human & Natural Resources Division

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Deputy Attorney General
Judicial Affairs Division

Walter A. McFarlane
Deputy Attorney General
Finance & Transportation Division

Karl E. Bren
Director of Administration

April 10, 1985 4/15

The Honorable George H. Heilig, Jr.
Member, House of Delegates
700 Newtown Road
Norfolk, Virginia 23502

My dear Delegate Heilig:

You have asked whether a Maryland savings and loan association supervised by the State of Maryland falls within the phrase "state...savings and loan associations" in §§ 6.1-330.25 and 6.1-330.48 of the Code of Virginia, so as to exempt its loans from Virginia usury laws.

Sections 6.1-330.25 and 6.1-330.48 provide that certain loans are exempt from various usury limitations in the Code. Both sections exempt loans made by lenders licensed by and under the supervision of the State Corporation Commission or the federal government. Each section also exempts "loans made by state and national banks, state and federal savings and loan associations and state and federal credit unions."[1]

The predecessor to § 6.1-330.25 did not refer to state and national banks, state and federal savings and loan associations and state and federal credit unions. See § 6.1-330.3 (Repl. Vol. 1973), repealed by Ch. 448, Acts of Assembly of 1975. By adding the language, a change in existing law is presumed intended.[2]

---

[1]Section 6.1-330.25 provides, in its entirety, and § 6.1-330.48 provides, in essence:
"Sections 6.1-330.16, 6.1-330.24 and 6.1-330.31 shall not apply to loans made by any lender licensed by, and under the supervision of the State Corporation Commission or the federal government, or to loans made by state and national banks, state and federal savings and loan associations and state and federal credit unions."

[2]Although the Virginia Code Commission Report on the change states that its purpose was to clarify existing law, the fine line between clarification and substantive change was also noted. Report of the Virginia Code Commission to the Governor and the General Assembly of 1975, Sen. Doc. No. 38 at 3.

Richmond v. Sutherland, 114 Va. 688, 77 S.E. 470 (1913). Moreover, the statute should not be interpreted in a manner which would render a portion of it meaningless. Commonwealth v. Community Motor Bus, 214 Va. 155, 198 S.E.2d 619 (1973). Because Virginia banks, savings and loan associations and credit unions were already included in the language of repealed § 6.1-330.3, and are included in §§ 6.1-330.25 and 6.1-330.48, by virtue of references to lenders licensed or supervised by the State Corporation Commission, it appears that the purpose of the additional reference to "state...savings and loan associations" in those latter sections was to extend the statute to additional savings and loan associations from other states.

This interpretation is consistent with the provisions of § 6.1-195.58 which prohibit an out-of-State corporation from conducting a savings and loan business in Virginia. That section does allow for an out-of-State entity to make certain loans in Virginia. It states, in part:

> "Nothing in this chapter [the Virginia Savings and Loan Act] shall prevent any person from lending money on real estate or personal security or collateral...."

Thus, a Maryland savings and loan association, although not authorized to conduct a savings and loan business in Virginia, may have loans lawfully outstanding in Virginia in certain circumstances.

Under this interpretation of §§ 6.1-330.25 and 6.1-330.48, all of the loans exempted would be loans made by lenders regulated by one of the states or the federal government. Such lenders are, therefore, likely to be subject to government scrutiny similar to that which permits the exemption of Virginia lenders' loans. Because out-of-State savings and loan associations may make loans in Virginia under § 6.1-195.58, it is appropriate to construe the statutes to exempt those loans from the same usury statutes as similar loans made by Virginia savings and loan associations in order to assure equal treatment of borrowers and lenders which are similarly situated.

I have intentionally delayed my response to you in order to await the decision of the Supreme Court of the United States in a related tax question. In Metropolitan Life Ins. Co. v. Ward, ___ U.S. ___, 53 L.W. 4399 (March 26, 1985), the Court held that an Alabama tax differential imposed more heavily on out-of-state insurance companies violates the Equal Protection Clause. See also Bacchus Imports, Ltd. v. Dias, ___ U.S. ___, 52 L.W. 4979 (June 29, 1984) (holding that a Hawaii liquor tax, imposed only on out-of-state liquors, impermissibly burdened interstate commerce in violation of the Commerce Clause of Art. I, § 8 of the Constitution of the United States).

To summarize, I am of the opinion that the language of §§ 6.1-330.25 and 6.1-330.48, exempting certain loans made by state savings and loan associations from various usury statutes, includes savings and loan associations chartered by the other states, as well as Virginia.

With kindest regards, I am

Sincerely,

Gerald L. Baliles
Attorney General

2:11/54-355

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MEMORANDUM

June 17, 1985

TO: Joint Subcommittee Studying the Revision of the Savings and Loan Laws and the Interest Rate Laws of the Commonwealth and the Issue of Interstate Banking

FROM: Thomas & Fiske, P.C.

RE: Technical Amendments to the Virginia Savings Institutions Act of 1985

This memorandum will serve to report to the Joint Subcommittee on technical amendments which are proposed to remedy certain unintentional deletions and technical errors in the Virginia Savings Institutions Act of 1985, and to clarify certain provisions in the Act.

Section 6.1-194.41, Subsection E. The state of Arkansas needs to be added to the list of states comprising the Southeast Region for purposes of interstate operations by mutual savings and loan associations. Arkansas is included in the region in other sections of the Act, but was inadvertently omitted from Subsection E of Section 6.1-194.41. Therefore, "Arkansas," should be inserted after "Alabama," in the first sentence of Subsection E.

Section 6.1-194.54, Subsection B. Subsection B needs to be amended so that state-chartered savings and loan associations can offer self-directed individual retirement accounts (IRA's). The need for this change is explained in a

June 4, 1985 letter written by Michelle H. Gluck, an attorney with Hunton & Williams, a copy of which is attached. It is recommended that the second sentence of Subsection B be amended as follows:

> Contributions may be accepted and interest thereon retained by such institution pursuant to forms provided by it and ~~must~~ may be invested in accounts of the institution in accordance with the terms upon which such contributions were accepted.

Section 6.1-194.91, Subsection C. The date "July 1, 1977" presently contained in Subsection C should be changed to "July 1, 1985", the effective date of the new Act. Otherwise, Subsection C is nonsensical.

Section 6.1-194.93. Because of a typographical error, the phrase "release of substitution of security therefor" contained in this section should be changed to read: "release or substitution of security therefor..."

Section 6.1-194.95, Subsection A. The words "authorized to transact business in the Commonwealth" should be inserted after the words "federal savings institutions" presently contained in Subsection A. Otherwise, Subsection A might be read as permitting all federal savings institutions to transact business in the Commonwealth, whether or not they had received formal authorization from the Federal Home Loan Bank Board.

Section 6.1-194.14. Although no change is presently recommended for this section, it is requested that the Subcommittee consider whether there is any value in retaining the requirement that directors of a stock association be required to own stock in the association having a book value of $500. This requirement has caused confusion and probably no longer serves any useful purpose. See attached June 12, 1985 letter written by Gregory B. Nevers, an attorney with McGuire, Woods & Battle.

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FILE NO.
DIRECT DIAL NO. 804 788- 8524

FILE: ________

June 4, 1985

S. Miles Dumville, Esquire
Thomas & Fiske, P.C.
310 South Boulevard
Post Office Box 14515
Richmond, Virginia 23221-0515

Technical Amendment to the New
Virginia Savings Institutions Act

Dear Mr. Dumville:

Hunton & Williams serves as counsel to Cardinal Savings & Loan Association ("Cardinal") in Richmond, Virginia. Recently, Cardinal asked us to determine whether it could offer a self-directed IRA product to its customers in order to continue to compete effectively with Virginia banking institutions that already offer such a product.

No Federal Home Loan Bank Board regulation restricts savings and loan associations from offering self-directed IRA's. Nonetheless, Va. Code §6.1-195.49:1 (1983), read literally, seems to prohibit such a product. Section 6.1-195.49:1 provides:

> To the extent allowed by federal law a federally insured association may act as trustee or custodian of individual retirement accounts under the Federal Employee Retirement Security Act of 1974, as from time to time amended. Contributions may be accepted, and earnings thereon retained, by such association pursuant to forms provided by it and must be invested in savings accounts of the association in accordance with the terms upon which such contributions were accepted.

This section appears to prohibit a savings and loan association from offering self-directed IRA's because it provides that contributions and earnings thereon must be invested in savings accounts of the association. Upon the effective date of the new Virginia Savings Institutions Act, §6.1-194.54(B) will replace §6.1-195.49:1 but will not alleviate the problem. Section 6.1-194.54(B) does not require investment in savings accounts alone of the institution, but does limit investment to accounts of the institution.

This requirement of investment in savings accounts or accounts is inconsistent with the way the Va. Code treats the investment of funds under a Keogh plan under Va. Code §6.1-195.49 (1985) which provides:

> If and when an association is an insured, and to the extent allowed by federal law, it may act as trustee or custodian within the contemplation of the Federal Self-Employed Individuals Tax Retirement Act of 1962, as amended. Funds held as such trustee or custodian may be invested in savings accounts of the association if the trust, custodian or other plan does not prohibit such investment.

Section 6.1-195.49 provides that Keogh plan funds may be invested in savings accounts of the association rather than that they must be so invested. Other than changing savings accounts to accounts, §6.1-195.49 is not substantively changed by the new Virginia Savings Institutions Act, although its section number will change to §6.1-194.54(A).

In light of the fact that there is no apparent reason for the distinction between Va. Code §6.1-195.49:1 (new §6.1-194.54(B)) and §6.1-195.49 (new §6.1-194.54(A)) and because it is important for savings and loan associations to be allowed to offer self-directed IRA's in order to compete effectively with other banking institutions in Virginia, we suggest that a technical revision to new §6.1-195.54(B), which would make it consistent with new §6.1-195.54(A), is in order. Such a revision could be simply effected by changing the word "must" in §6.1-195.54(B) to the word "may" in §6.1-195.54(A). We would appreciate being kept apprised of all plans to adopt such a revision. Should you have any questions, please feel free to call.

Very truly yours,

Michelle H. Gluck

Michelle H. Gluck

348/539

cc: Mr. Mayo C. Harlow, III
Mr. Brian M. Thurston
Lewis T. Booker, Esq.
Dewey B. Morris, Esq.
Bernard V. Kearse, III, Esq.

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June 12, 1985

By Hand

Mr. Mark W. Saurs
President
Virginia Savings and Loan League
Imperial Building, Suite A
5th & Franklin Streets
Richmond, Virginia 23219

Dear Mr. Saurs:

As we discussed the other day by phone, on behalf of Colonial Savings and Loan Association, we are requesting the assistance of the Virginia Savings and Loan League in obtaining an interpretation of certain provisions of Virginia's recently adopted Virginia Savings Institution Act (the "Act").

As you are aware, Section 6.1-194.14 of the Act requires every director of a stock association to own in his own name and have in his personal possession or control, shares of stock in the association of which he is a director, which have a book value of not less than $500. This section is very ambiguous and difficult to interpret because it fails to specify a date on which book value should be measured. In addition, the statute may create problems for associations, like Colonial, whose total authorized capital stock is already issued and outstanding. In this situation there are no additional shares available for purchase by directors not meeting this requirement.

These difficulties may be further compounded by the provision found at the end of paragraph B of the statute which states: "[t]he office of any director violating the provisions of this section shall immediately become vacant." We believe this particular provision should be limited in its application to the requirements for directors of a mutual association as set out in paragraph B rather than the provisions for stock associations set out in paragraph A of §6.1-194-14. The literal terms of the statute, however, do not clearly indicate that this should be the result.

In light of these problems, and in light of the fact that this new statute will become effective on July 1, 1985, we ask that the Virginia Savings and Loan League request, on behalf of its members, an interpretation from the Bureau of Financial

Institutions that book value for purposes of the new statute will be measured as of July 1 of each year and that the automatic vacancy provision applies only to directors of mutual associations. We also ask the League's assistance in obtaining a legislative solution (perhaps to simply do away with these outdated and ineffective requirements) to these problems this fall.

Thank you for your assistance.

Sincerely,

Gregory Nevers

Gregory B. Nevers

GBN/dlk

cc: O. H. Harriss, President
Colonial Savings and Loan Association

O. Randolph Rollins, Esquire

APPENDIX 10

HOUSE JOINT RESOLUTION NO. 41

Continuing the joint subcommittee established pursuant to House Joint Resolution No. 30 of 1984, and continued under House Joint Resolution No. 217 of 1985, to review the savings and loan and interest rate laws of the Commonwealth and interstate banking.

WHEREAS, House Joint Resolution No. 30 of the 1984 General Assembly established a joint subcommittee to study the issue of interstate banking and to revise the savings and loan laws and interest rate laws of the Commonwealth; and

WHEREAS, although the joint subcommittee was able to complete for the most part its work on the interstate banking issue and on the revision of the savings and loan laws, it was unable to complete its work on the interest rate laws revision because of the complexity of the issues and thus was carried over for additional study by House Joint Resolution No. 217 of the 1985 General Assembly; and

WHEREAS, the interest rate subcommittee of the full joint subcommittee was for the most part able to complete its work on the interest rate revision yet feels it needs to continue its study to fine-tune and monitor the law changes; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the joint subcommittee established pursuant to House Joint Resolution No. 30 of the 1984 General Assembly and continued pursuant to House Joint Resolution No. 217 of the 1985 General Assembly, be requested to continue its study of the savings and loan and interest rate laws of the Commonwealth, and interstate banking.

During its study the joint subcommittee shall not only continue to work on the interest rate revision but shall also: (i) continue to monitor interstate banking and savings legislation and activities; (ii) study the credit card situation in Virginia; (iii) consider some sort of regulatory scheme for unsupervised lenders; and (iv) study add-on interest rates to determine whether they should be abolished.

The membership of the joint subcommittee shall remain the same and any vacancy that should occur in the membership shall be filled by the same person or committee as provided in House Joint Resolution No. 30 of 1984.

All agencies of the Commonwealth shall assist the joint subcommittee in its study.

The joint subcommittee shall complete its work in time to submit recommendations to the 1987 Session of the General Assembly.

The costs, including direct and indirect costs, of this study are estimated to be $18,600.