

Department of Legislative Services  
Maryland General Assembly  
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 827  
Finance

(Senator Conway)

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Commercial Law - Prepayment Charges - Actions

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This bill alters the existing six-month statute of limitations for actions brought due to specific violations of statutory credit grantor closed-end credit provisions. The bill permits an action for an unlawful prepayment penalty to be brought within three years after a prepayment charge is imposed on a consumer borrower.

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Fiscal Summary

**State Effect:** The bill would not directly affect State finances or operations. If the Attorney General's Office receives fewer than 50 complaints per year stemming from the bill, the additional workload could be handled with existing resources.

**Local Effect:** The bill would not directly affect local finances or operations.

**Small Business Effect:** Potential minimal.

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Analysis

**Current Law:** Under current State law, an action for any violation of statutory credit grantor closed-end credit provisions may not be brought more than six months after the loan at issue is satisfied. State law specifically prohibits credit grantors from imposing any prepayment charge in connection with any prepayment of any loan by a consumer borrower under the statutes governing closed-end credit (an extension of credit by a credit grantor to a borrower under an arrangement or agreement which is not a revolving credit plan).

**Background:** Prepayment penalties charged by lenders of consumer loans have become the focus of recent legislative attention due to a recent decision by Maryland Court of Appeals. On December 13, 2007, the court concluded in *Andrew Bednar v. Provident Bank of Maryland* that the practice of closing cost “recapture” violates the Maryland Credit Grantor law. Under a closing cost recapture plan, a lender pays the borrower’s loan closing costs and agrees to defer collection of these costs from the borrower as long as the borrower keeps the loan open for a period of time. If the borrower keeps the loan open for the specified time, the lender forgives the closing costs, but if the borrower prepays and closes the loan, then the borrower is required to pay these costs to the lender. Closing cost recapture programs are a standard practice of lenders across the nation that offer an initial incentive to the borrower in exchange for an increased assurance that the borrower will not repay the loan before a certain time, as would occur if the borrower refinanced with another lender.

In *Bednar*, the Court of Appeals examined current State statute with respect to a situation in which a borrower who prepaid his loan was then charged for closing costs that had been initially paid by the lender. The court concluded that this charge was a prepayment charge that violated the Credit Grantor law, stating:

It is undisputed that whether Bednar would be required to pay the \$681 charge was entirely dependent upon whether he prepaid the Provident loan within three years. If Bednar prepaid the loan within three years, he was required to pay the charge. If he did not prepay the loan within three years, he was not required to pay the charge. Regardless of what else the \$681 charge may have been, or how the amount was calculated, it was plainly a “prepayment charge.” Section 12-1009(e) of the Commercial Law Article unambiguously and flatly mandates that, “[i]n connection with any prepayment of any loan by a consumer borrower, the credit grantor may not impose any prepayment charge.” “Any” prepayment and “any” prepayment charge does not mean only “some” prepayments or “some” prepayment charges.

The court further noted that other jurisdictions reviewing these matters have similarly held that, when a charge is conditioned on prepayment, it constitutes a prepayment charge. In addition, the court held current State statutory law did not permit Provident to impose the “recapture” charge based on the closing costs waiver certificate signed by Bednar, in which he agreed to the recapture program. The court based this holding on Section 12-1023(b)(3) of the Commercial Law Article, which states that, “[e]xcept as expressly allowed by law, an agreement, note, or other evidence of a loan may not contain a provision by which the borrower waives any right accruing to the borrower under this subtitle.” The court also noted that the same statute deems any such clause in agreement as unenforceable.

In its conclusion, the court rejected Provident's reliance on prior opinion letters from two previous Commissioners of Financial Regulation that had interpreted loan closing cost recapture programs as permissible and not in violation of statutory bans on prepayment penalties. The court concluded:

Provident also cannot properly circumvent § 12-1009(e) by calling the imposition of the charges a "recapturing" of permitted costs. A person or entity is not permitted to evade statutory prohibitions by using a different label for the prohibited conduct.... Our holding in this case does not impose a time limit on collecting permissible charges. Rather, we simply hold that the collection of such charges may not be dependent upon prepayment.

Due to the *Bednar* decision, Maryland-chartered banks, credit unions, and independent mortgage lenders are no longer permitted to employ loan closing cost recapture programs in order to initially waive these costs for borrowers. Due to federal preemption, however, financial institutions and affiliated mortgage lenders that are federally chartered or chartered in another state will continue to be able to offer closing cost recapture to borrowers when they do business in Maryland. This places Maryland-chartered lenders at a significant competitive disadvantage, because they are forced to charge closing costs upfront while their national and out-of-state counterparts are not.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Office of the Attorney General (Consumer Protection Division); Department of Legislative Services

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