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ADVISORY RULING #96
MAY 2, 1990

May 2, 1990

Re: FNMA "Two Step" Mortgage Program

Dear

You have requested an Advisory Ruling pursuant to 9-A M.R.S.A. §6-104 on the issue of whether a FNMA "Two Step" mortgage product proposed for use in this State is consistent with the limitations imposed by Maine Bureau of Consumer Credit Protection Rule 250, "Alternative Mortgage Transactions." Specifically, the rule in §4(A)(3) establishes that creditors may not raise the interest rate on a discounted loan "more than ... 2% for any one year." The FNMA program involves a slightly-discounted fixed rate for the first seven (7) years, followed by a one-time adjustment of as much as 6% to a second fixed rate for the remainder of the 30-year term.

I am convinced that the program is not inconsistent with the rule. I have considered the following factors in my decision:

1) This Bureau's rule was drafted primarily to address one-year deep-discount products. The Bureau has a legitimate concern in limiting potential rate increases in mortgage programs which attract customers through short-term deeply discounted initial terms ("teaser rates"). Those concerns are greatly lessened in the case of a seven-year initial fixed term.

2) The phrase "2% for any one year" does not necessarily preclude a rise of six percentage points after a seven-year initial plateau. This new FNMA product would clearly be prohibited by a rule which limited a rise to "2% at any one time" or "2% in any 12-month period." However, the current

phraseology is more liberal, and no matter how low the initial rate, the average rise for any one year cannot exceed 2%.

3) Even assuming the maximum 6% interest rate increase after the seventh year, this product involves less potential for "rate shock" than either a straight balloon program or another new product, the FNMA "7/23 extended balloon" plan, both of which are allowed under Bureau Rule 250. A balloon note carries a much harsher possible outcome, given the variables which may affect refinancing such as interest rate, consumer circumstances and availability of funds.

This Advisory Ruling responds to a specific question about a specific product, namely the FNMA "two Step" program, and should not be deemed to extend to other discount proposals.

In light of this and similar proposals, the Bureau plans a review of its Rule 250 in conjunction with a Bureau of Banking revisitation of its Rule 19.

Sincerely,

William N. Lund
Superintendent

WNL/bas