

November 2002
Bulletin 02-44

Anti-Predatory Lending Efforts Continue in New York

If you have questions or would like additional information on the material covered in this Bulletin, please contact one of the authors:

*Robert M. Jaworski
(Princeton)
609.520.6003
rjaworski@reedsmith.com*

*Barbara S. Mishkin
(Philadelphia)
215.851.8145
bmishkin@reedsmith.com*

*Patricia E. Obara
(Princeton)
609.514.5988
pobara@reedsmith.com*

*Samuel Veytsman
(New York)
212.549.0283
sveytsman@reedsmith.com*

...or the Reed Smith attorney with whom you regularly work.

New York State Pushes the Envelope Further

New York was one of the first states to tackle the problem of predatory lending. Effective October 1, 2000, the New York State Banking Board adopted Part 41 of its General Regulations, known as the High-Cost Home Loans Regulation. Since then, efforts have been made to enact even tougher legislative solutions, with the senior citizens' lobby in New York being particularly active in this regard.

These efforts recently coalesced around Assembly Bill A. 11856 (Chapter 626), which the Governor signed into law on October 3, 2002 (the "NY Statute"). The NY Statute will be effective as to loans applied for on or after April 1, 2003.

Coverage. The NY Statute defines a "high-cost home loan" as a closed- or open-end mortgage loan (but not a reverse mortgage loan) (i) which is made to a natural person primarily for personal, family or household purposes, (ii) the principal amount of which does not exceed \$300,000 or the FNMA conforming loan size (currently at \$300,700 for a single-family home), whichever is less, (iii) which is secured by a 1-4 family dwelling located within the state that is used or to be used as the borrower's principal dwelling (a "home loan"), and (iv) which equals or exceeds either the rate threshold or the points and fees threshold, described below.

The rate threshold is an annual percentage rate ("APR") (using the fully indexed rate, not a teaser rate) of, for first lien mortgage loans, 8 percent, and, for subordinate liens, 9 percent, over the yield on U.S. Treasury securities with comparable periods of maturity.

The points and fees threshold is (i) 5 percent of the "total loan amount" (the principal amount of the loan minus any financed points and fees) for loans of \$50,000 or more, (ii) 6 percent of the total loan amount for FHA or VA loans of at least \$50,000, and (iii) the greater of 6 percent or \$1500 for loans under \$50,000.

"Points and fees" include (i) all items included as "points and fees" under the federal Home Ownership and Equity Protection Act, Pub. L. 103-325, 109 Stat. 2160 ("HOEPA"), as defined in the current version of Section 32 of Regulation Z (which implements HOEPA), 12 C.F.R. § 226.32, effective October 1, 2002, (ii) all indirect mortgage broker compensation, and (iii) the cost of all financed single premium "credit disability, credit unemployment, credit property insurance or any other life or health insurance" (to the extent that they do not constitute premiums paid at or before closing for "credit life, accident, health, or loss-of-income insurance, or debt cancellation coverage," which are already included as points and fees under Section 32 of Regulation Z).

LONDON
NEW YORK
LOS ANGELES
SAN FRANCISCO
WASHINGTON, D.C.
PHILADELPHIA
PITTSBURGH
OAKLAND
PRINCETON
NORTHERN VA
WILMINGTON
NEWARK
COVENTRY, U.K.
CENTURY CITY
RICHMOND
HARRISBURG
WESTLAKE VILLAGE

When calculating points and fees, up to two “bona fide discount points” may be excluded. “Bona fide discount points” are points knowingly paid by the borrower to lower the interest rate on the loan and which in fact do lower the interest rate (the “Start Rate”) by an amount “reasonably consistent with established industry norms and practices.” A point is presumed to be a bona fide discount point if it lowers the Start Rate by at least 25 basis points. Bona fide discount points may be excluded from “points and fees” only if the Start Rate does not exceed by more than 1 percent the yield on U.S. Treasury securities with comparable periods of maturity.

Restrictions and Limitations. The NY Statute prohibits a host of activities and/or provisions in connection with high-cost home loans, including call provisions, balloon payments (which come due 15 years or sooner into the loan term), negative amortization, higher default interest rates, modification and deferral fees (unless the modified loan is no longer a high-cost loan and the rate has been decreased by at least 2 percent), “oppressive” mandatory arbitration clauses, lending “without due regard to repayment ability,” financing of single premium credit insurance or debt cancellation benefits, lending without specified counseling disclosures, financing points and fees in excess of 3 percent of the principal amount of the loan, and charging points and fees in connection with a refinance of a lender’s own or an affiliate’s high-cost home loan with another high-cost home loan.

The NY Statute also prohibits lenders and brokers from engaging in the practice of “loan flipping,” *i.e.*, “refinanc[ing] an existing home loan [with a high-cost home loan] when the new loan does not have a ‘tangible net benefit’ to the borrower considering all of the circumstances;” and payments to or from mortgage brokers in connection with the origination of a high-cost home loan that are not reasonably related to the value of goods, facilities or services actually provided by the mortgage broker.

Required Disclosures. Under the NY Statute, lenders or brokers, within certain time limits, must provide the loan applicant with a prescribed warning notice about the loan, which is substantially more involved than the similar Part 41 disclosure. In addition, all mortgages securing high-cost home loans must identify themselves as such in 12-point type at the top.

Enforcement. The NY Statute is enforceable by the Attorney General, the Superintendent of Banking, or any individual borrower (by way of a private action brought within six years of the loan origination). Persons found to have violated the NY Statute (and who did not avail themselves of the limited right provided in the NY Statute to “cure” a good faith violation) can be liable to the borrower for actual (including consequential and incidental) damages, statutory damages (all of the interest, points and fees, and closing costs charged on the loan), and reasonable attorneys’ fees. With regard to violations of the flipping provision or (in certain situations) the prohibition against lending without regard to repayment, statutory damages are set at the greater of \$5,000 per violation or twice the amount of points and fees and closing costs charged on the loan. Violations of the NY Statute also provide borrowers with a right to rescind a high-cost home loan at any time as a defense to collection or foreclosure. Intentional violations of the NY Statute render a high-cost home loan void.

Assignee Liability. Under the NY Statute, borrowers may assert, without any time limitation, in any action by an assignee to enforce a high-cost home loan in default more than 60 days or to foreclose on a high-cost home loan, any claims or defenses that the borrower could assert against the original lender.

No Preemption of Local Laws. Conspicuously absent from the NY Statute is any mention of it having a preemptive effect upon local government initiatives in this regard. Such an initiative was in fact recently approved by the Council of the City of New York (the “City”), and is summarized below.

New York City About to Join in the Fray

Proposed Int. No. 67-A (the “NYC Ordinance”), which was approved by the City Council on September 25, 2002, will make it illegal, beginning 90 days after it becomes law, for a City agency to enter into business contracts with, grant financial assistance—including tax abatements—to, or deposit City funds in, a “predatory

lender" or its affiliate. (The Mayor vetoed the bill on October 23, 2002; however, an override vote by the City Council, which originally approved the bill by a vote of 44-5, appears likely.)

Coverage. Predatory lenders are defined in the NYC Ordinance to include, with certain exceptions, financial institutions (including banks and thrifts, credit unions, mortgage bankers and mortgage brokers, and other financial services companies) that make, purchase or invest in, within a 12-month period, the greater of 10 loans, or loans comprising at least 5 percent of their home loan business, which are "predatory loans." Predatory loans are "high-cost home loans" having any one or more of 18 identified characteristics which the City Council apparently believes are, at least potentially, predatory or abusive.

High-cost home loans include all open- and closed-end loans (other than reverse mortgage loans) (i) the principal amount of which are not in excess of the greater of \$300,000 or the Fannie Mae conforming loan limit, (ii) which are made to a natural person primarily for personal, family or household purposes, (iii) which are secured by a 1-4 family dwelling located in the City that is used or is to be used as the borrower's principal dwelling ("home loans"), and (iv) which equal or exceed either the rate threshold or the points and fees threshold, explained below.

Both the rate threshold and the points and fees threshold are lower than the thresholds in the NY Statute. The rate threshold is an APR (using the fully indexed rate, not a teaser rate), of, for first-lien loans, 6 percent, or, for subordinate-lien loans, 8 percent, over the yield on U.S. Treasury securities of comparable maturities. The points and fees threshold is (a) 4 percent of the total loan amount (which is not defined), for loans of \$50,000 or more, or (b) the greater of 5 percent of the loan amount or \$1500, for loans under \$50,000.

"Points and fees" are defined in the NYC Ordinance to include the same items as are included in the definition of "points and fees" in the NY Statute (except that premiums for the various types of credit insurance delineated in both the NY Statute and the NYC Ordinance appear to count as points and fees under the NYC Ordinance regardless whether or not they are financed as part of the loan), plus any prepayment fees charged in connection with the payoff of a loan being refinanced by the same lender or its affiliate. Up to four "bona fide loan discount points" (points knowingly paid by the borrower to lower the Start Rate, and which in fact do lower the Start Rate, by an amount that is "reasonably consistent with established industry norms and practices") will not count as "points and fees" provided that the Start Rate does not exceed by more than 2 percent the required net yield on a standard Fannie/Freddie mandatory delivery commitment for a reasonably comparable loan.

Predatory Characteristics. Some of the characteristics which the City Council believes can, singly or as a group, transform a high-cost home loan into a predatory loan are :

- ✍ The loan refinances an existing home loan without providing the borrower with a "reasonable and tangible benefit...considering all the circumstances;"
- ✍ When the loan was made, the lender did not have a reasonable basis to believe that the borrower would be able to repay it;
- ✍ Financed points and fees exceed 4 percent of the loan amount (or credit limit);
- ✍ The lender did not obtain a certification that the borrower received credit counseling prior to closing;
- ✍ The loan provides for a balloon payment;
- ✍ The loan provides for a prepayment fee (for a payoff made more than one year after closing);
- ✍ The loan includes an "unfair" or "oppressive" mandatory arbitration clause;
- ✍ The loan refinances within five years a high-cost home loan made by the same lender (or an affiliate) and includes points and fees.

Client Bulletin 02-44

Filing Requirements. Under the NYC Ordinance, financial institutions wishing to contract with or receive financial assistance from a City agency or act as a depository for City funds must provide the City with a sworn statement that neither the institution nor any of its affiliates is or will become a predatory lender. Filing a false statement can result in a fine of not less than \$25,000 in addition to other penalties.

Other Consequences of Being a Predatory Lender. The NYC Ordinance authorizes the City comptroller to recommend that the City not invest in, and/or divest, stocks or securities of a predatory lender or predatory lender affiliate.

The City comptroller can also investigate an institution that does business with the City to determine whether it is a predatory lender, and, if it is, require corrective action and request City agencies to cease doing business with it and take further appropriate action.

Prohibition Applicable to Home Improvement Contractors. The NYC Ordinance would also prohibit home improvement contractors from steering borrowers towards specific home loan lenders and from receiving payment directly from the proceeds of a high-cost home loan.

* * * * *

The NY Statute and the NYC Ordinance, copies of which are available upon request (from any of the contacts listed on this Bulletin) are significant developments for anyone brokering, making or purchasing home loans, particularly subprime home loans, in the State of New York and/or New York City. Both laws are extremely complex and should be carefully analyzed to ensure compliance. Reed Smith's Consumer Financial Group provides federal and state law compliance advice and assistance to banking institutions and other providers of consumer financial services; assists with regulatory and licensing issues; and performs loan and document reviews and compliance audits. Members of the Group also team with Reed Smith financial services litigators in defending clients in individual and class action litigation. The authors of this Bulletin, along with other members of the Group, are available to answer questions or concerns that you may have concerning these important New York developments, and similar developments elsewhere.

Reed Smith is organizing an effort at the NY City Council to reach out to key members and staff to argue for deferral of consideration of an override of the veto or alternatively improvements in the proposed law. In addition, an effort is being organized at the New York State level to lobby for chapter amendments to the state law which would attempt to alleviate some of the problematic features of the law however, since it becomes effective on January 1, 2003, time is short. If you would like more information on these efforts, please contact Robert Miller, a partner in Reed Smith's New York office at 212.549.0249 or rmiller@reedsmith.com.

* * * * *

Reed Smith, a leading global law firm with more than 750 lawyers located in 11 U.S. and two U.K. cities, represents Fortune 100 as well as mid-market and emerging companies. Clients include technology companies and entrepreneurs, financial services firms, health care providers and insurers, communications companies, manufacturers, universities, non-profit organizations, real estate developers, and municipalities throughout the United States and in 40 countries. For more information, please visit [reedsmith.com](http://www.reedsmith.com). If you would like to receive future client bulletins via e-mail, please sign up on our Web site at <http://www.reedsmith.com/admin/contact.asp>.