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BULLETIN NO. 03-30

TO: ALL INTERESTED PARTIES

FROM: HOLLY C. BAKKE, COMMISSIONER

RE: THE NEW JERSEY HOME OWNERSHIP SECURITY ACT OF 2002

The New Jersey Department of Banking and Insurance ("Department") is issuing this Bulletin as a supplement to Bulletin No. 03-15, issued July 24, 2003, in response to questions that have been raised about the New Jersey Home Ownership Security Act of 2002 (the "Act"), N.J.S.A. 46:10B-22 et seq., signed into law on May 1, 2003. The Act addresses certain abusive lending practices, and is designed specifically to prevent the issuance of those high-cost loans that are harmful to consumers. This Bulletin provides additional guidance about the operation and enforcement of the Act in response to the various questions and issues raised by interested parties. This Bulletin is for guidance purposes only and is not intended to constitute a discussion of all aspects of the Act. In the interest of consistency, the question numbering continues from Bulletin No. 03-15.

Assignee/Purchaser Safe Harbor

Question 12:

An issue was raised whether the Department would consider it sufficient to demonstrate "by a preponderance of the evidence, that a reasonable person exercising reasonable due diligence could not determine that a mortgage loan is a high-cost home loan" under N.J.S.A. 46:10B-27b.

In determining whether an assignee or purchaser has satisfied this standard, the Department will review whether it has fulfilled the three-prong test delineated by N.J.S.A. 46:10B-27b. Specifically, the Department will consider a purchaser or assignee as having met the requirements of the provision if it:

(1) has in place at the time of the purchase or assignment of the loan, policies that expressly prohibit its purchase or acceptance of assignment of any high-cost home loan;

(2) requires by contract that a seller or assignor of home loans to the purchaser or assignee represents and warrants to the purchaser or assignee that either: (a) it will not sell or assign any high-cost home loan to the purchaser or assignee; or (b) that the seller or assignor is a beneficiary of a representation and warranty from a previous seller or assignor to that effect ; and

(3) exercises reasonable due diligence at the time of purchase or assignment of a home loan, or within a reasonable period of time thereafter, intended by the purchaser or assignee to prevent the purchaser or assignee from purchasing or taking assignment of any high-cost home loan.

Question 13:

A question was raised regarding what role a third-party software package or internally developed computer program may properly take in efforts designed to meet the requirements of the law.

The Department believes that appropriately designed and utilized third party software packages or internally developed computer programs can serve as an important component in helping lenders meet the requirements of the statute. The Department expects that use of such software will expand the ability of lenders to determine which provisions of the law apply to the loans they originate by systematically tracking a much larger number of loans than could be done manually. The Department recognizes that software packages are available and used for determining compliance with the Truth In Lending Act and other lending laws and regulations. The Department understands that computer systems and software packages are now available that, when used effectively, can enable lenders to determine easily whether loans are home loans, covered loans, or high cost loans under the Act. These tools can also identify more quickly loans requiring particular attention, and reduce compliance costs.

It is important, however, to recognize that any software program relied upon must be calibrated and tested prior to use, periodically tested as part of the ongoing compliance review process, and used in a fair and reasonable manner. Even with the use of software, periodic manual oversight and monitoring is still expected to ensure that the software is used appropriately and performs adequately (e.g., data is inputted correctly), and to evaluate matters that may not be addressed by the software.

Of course, there is no requirement that a lender must use such computer systems, and the Department expects that a certain number will elect not to rely on them. Lenders are free to choose whatever mechanism is most appropriate for them. The Department's focus will be on ensuring that whatever policies, procedures, and mechanisms a lender chooses are appropriate for compliance with the law.

Question 14:

A question was raised as to what the Department expects when a purchaser or assignee determines, as part of its initial review of loans in a pool, that there are high cost loans included in the pool, even though the entities selling or assigning the loans made representations that no such loans were included.

Consistent with the Department's response to Question 9 in DOBI Bulletin 03-15, in these circumstances, the Department expects that there will be a substantially upgraded review of the loan pool to evaluate such loans, the reliability of representations and warranties in place that there are no high-cost loans in the pool, and the extent to which there are other high cost loans in the pool. In addition, the Department expects that all appropriate steps will be undertaken to have such loans returned to the entity that sold or assigned them. The extent of this review depends upon a number of factors, including the overall size of the pool, the number of high-cost loans identified during the initial due diligence process and how extensive that initial process was, and the other procedures in place by originators to identify high-cost loans and exclude them from the loan pool.

Covered Loans

Question 15:

A question was raised as to what the restrictions are regarding the small segment of subprime loans considered “covered" loans under the Act. Under the Act, the category of “covered" home loan describes a small set of subprime loans where the points and fees (as defined under the law and subject to certain exclusions described in the Act) exceed 4 percent of the total loan amount or 4.5 percent for loans under $40,000 or insured by the FHA or VA. Any high-cost home loan is also considered a “covered home loan.”

Restrictions that apply to all "home loans" also apply to covered home loans. These restrictions include the following:

(1) No financing of credit insurance;
(2) No encouraging of default;
(3) No charging of a late payment fee in excess of five percent of the amount of the payment due;
(4) No acceleration of the indebtedness at the sole discretion of creditor; and
(5) No charging for payoff information

In addition, the prohibition against the abusive practice of flipping contained in N.J.S.A. 46:10B-25b applies to covered loans. More specifically, N.J.S.A 46:10B-25b provides that a “reasonable tangible net benefit” standard must be met when all three of the following conditions occur: (1) the new loan is a “covered loan” (2) it refinances an existing home loan, and (3) the existing home loan being refinanced was consummated within the prior 60 months. This means that the "reasonable tangible net benefit" standard set forth in this provision will not apply to the following loans:

(1) A "covered loan" used to purchase a home,
(2) A "covered loan" used to refinance non-home loans,

(3) A "covered loan" that refinances a home loan made more than 60 months prior to the new covered loan.

This also means that if the points and fees associated with the new refinance loan fall below the "covered" loan thresholds, then the "reasonable tangible net benefit" standard will not apply to the following loans, even when these loans refinance a home loan made within the 60 month period:

(1) A new loan (over $40,000) with points and fees of four percent or less;
(2) A new loan ($40,000 or less) with points and fees of 4.5 percent or less; and
(3) A new loan (FHA/VA) with points and fees of 4.5 percent or less.

In addition, see responses to Questions 10 and 11 in Bulletin No. 03-15 for further discussion of the flipping standard.

Question 16:

Another question was raised as to whether the flipping rule applies to a home loan, made before the November 27, 2003 effective date of the Act, when applying the "prior 60 month" condition to a covered refinance loan.

Although the effective date of the Act is November 27, 2003, the flipping rule applies to covered loans that refinance home loans consummated 60 months prior to the covered loan. This means that a covered loan closed on November 28, 2003 will be subject to the flipping rules if it refinances a home loan consummated on or after the equivalent date in the year of 1998.

Question 17:

A question was raised that if a creditor concludes that the flipping rule will not apply to its refinance based on a determination that the prior loan was consummated more than 60 months prior to the refinance, what evidence should the creditor maintain in order to show that the prior loan was actually consummated outside of the 60 month period.

The Department expects that a copy of a mortgage, note, Title or HUD disclosure statement or similar document indicating the closing date of the prior loan, will be available for review. A personal statement taken from the borrower will not be considered sufficient evidence of the closing date.

Home Improvement/Manufactured Homes

Question 18:

Several questions have been raised concerning particular aspects of N.J.S.A. 46:10B-27, which provides for limited assignee or purchaser liability in circumstances when there is the requisite degree of involvement by a home improvement contractor or manufactured home seller.

As stated in DOBI Bulletin 03-15, the Department understands that this provision is based upon the FTC Holder Rule and thus will rely upon that Rule, including the Staff Guidelines and other formal interpretations of it, in relevant areas. Therefore, for loans involving home repair contractors, the Department will apply this provision only to those loans which fall within the scope of the FTC Holder Rule, incorporating, for example, any requirement under the FTC Holder Rule involving how funds from the credit transaction are applied to the purchase of relevant goods and services. See, e.g., 16 C.F.R. 433.1(d). Further, the Department anticipates using the definition of "seller" under the FTC Holder Rule, 16 CFR 433, in determining who would qualify as a "person selling either a manufactured home or home improvements" under that provision. "Seller" as used in N.J.S.A. 46:10b-27 means the same as a 'seller' as defined under the FTC Holder Rule in 16 C.F.R. 433.1(j), that is 'a person who, in the ordinary course of business, sells or leases goods or services to consumers.'

This is also true, as noted in DOBI Bulletin 03-15, with regard to how much involvement a home improvement contractor or manufactured home seller must have in arranging the loan for the assignee liability in this provision to apply. Thus, consistent with the guidance under the FTC Holder Rule, the provision would not apply in a situation where a borrower arranges to refinance their home without the involvement of a home repair contractor or home improvement contractor. This is the case even when the borrower receives an amount of cash (whether incidental or not) in connection with the refinance, and applies the cash to home improvement expenditures. Consistent with the provision's clear language and as reflected in DOBI Bulletin 03-15, the Department understands that this provision applies even in circumstances when existing federal and state law is ignored and the required notice is not placed on the note. See DOBI Bulletin 03-15, Question 6. Regardless of how the FTC Holder Rule is interpreted in this regard, the Department will apply the provision accordingly.

Question 19:

As set forth in the response to Question 3 in DOBI Bulletin 03-15, the amount of damages that may be imposed against an assignee who purchases home improvement or manufactured housing loans pursuant to N.J.S.A. 46:10B-27a is capped in a manner similar to that in the FTC Holder Rule, 16 C.F.R. 433. More specifically, the Act specifies that the amount is "limited to amounts required to reduce or extinguish the borrower's liability under the home loan, plus the total amount paid by the borrower in connection with the transaction, plus amounts required to recover costs, including reasonable attorney's fees against the creditor, any assignee or holder, in any capacity." A question was raised as to what is meant by "the transaction" for the purpose of this section.

In this section, the term "the transaction" refers to the credit transaction. Whether payments to the seller of a manufactured home or home improvement repair are included in the calculation of amounts paid depends upon the relationship between the seller and creditor and the structure of the transaction.

Where the consumer receives a loan from a creditor by way of a referral or arrangement through the seller of the goods and services, "amounts paid in connection with the transaction," means the amounts paid to the originating creditor and subsequent holders. Because payments made to the seller such as a down payment or trade-in were not part of the credit transaction, such payments are not considered "paid in connection with the transaction." However, where the seller makes and/or assigns the loan to a creditor, payments to the seller are part of the credit transaction, and as such, are included in the calculation of amounts "paid in connection with the transaction." In other words, where the seller also acts as the original creditor, down payments, deposits, periodic payments, late fees, and other payments to the seller are included in the calculation of the maximum amount a borrower may recover through a claim brought pursuant to N.J.S.A. 46:10B-27a.

Question 20:

A question was also raised as to how a purchaser/assignee may determine whether a loan in a pool in which the borrower receives cash might constitute a home improvement loan subject to the limited liability for assignees and purchasers set forth in N.J.S.A. 46:10B-27a.

As the Department set forth in responses to Questions 4 and 5 of DOBI Bulletin 03-15, a loan in which a borrower receives cash is not a home improvement loan subject to the limited liability for assignees or purchasers unless a home improvement contractor made, arranged, or otherwise had the requisite degree of involvement in the origination of the loan. In response to Question 6, the Department explained how an assignee or purchaser would be able to determine whether a loan is a home improvement loan with the requisite degree of involvement by a home improvement contractor such that the terms of N.J.S.A 46:10B-27a apply. As a general matter, the Department notes that assignees or purchasers of home improvement loans have had limited assignee liability for almost thirty years pursuant to the FTC Holder Rule and thus this provision reinforces standards which do, or should, exist within the industry.

Posting Payments

Question 21:

The provision for posting a payment indicates that a creditor shall post such payment on the "date" received. A question was raised how this will be applied considering: (1) some lenders and depositories may receive mail or overnight delivery every day including Saturday and Sunday, while processing payments only on banking days; and (2) many depositories have cutoff times during any given day that place transactions into the next banking day.

The financial industry commonly executes transactions based on a banking day cycle that includes a start time and a finish time. The end of the date is frequently a specific time in the

afternoon, often after 2:00 or 3:00 p.m. For depository institutions, the Department will construe the word "date" to mean "banking day." For other financial service providers, the Department will construe the word "date" to mean any day that the provider is open for business provided that the payment is received before the close of business hours.

Authority of DOBI Regulatory Bulletins

Question 22:

A question was raised as to the basis for bulletins issued by the Department regarding the Act, and how reliable will they be in the event they are reviewed by the courts.

The Department is the regulatory body responsible for regulating and supervising the State banking and lending industry. This includes responsibility for licensing, examining, investigating, enforcing, and establishing rules governing this industry. The Act does not affect this responsibility. In addition, N.J.S.A. 46:10B-28 specifically provides for the Department to conduct examinations, investigations, and issue subpoenas and orders to enforce the Act. The Department may issue rules, bulletins, or orders to provide guidance to the industry. In circumstances such as the current one when a law does not provide for general authority to issue rules, the Department may issue bulletins to provide guidance to the industry of how the Department will enforce such a law. In preparing these bulletins, the Department has engaged in widespread consultation and research, reflecting its participation in at least three industry sponsored workshops, additional workshops at its own facilities, and conversations with numerous representatives of the industry and rating agencies regarding implementation and enforcement of the new law. The bulletins are also reviewed by the Office of the Attorney General before issuance.

LIMITATIONS ON DAMAGES FOR ASSIGNEES OR PURCHASERS

Question 23:

A question was raised whether the limitations on liability for assignees or purchasers under N.J.S.A. 46:10B-27 apply even when a borrower pursues claims for different types of damages, such as compensatory or punitive damages.

The Department provided important information concerning the limitations on damages in response to Questions 1 and 2 of DOBI Bulletin 03-15. Consistent with the explanations set forth therein, the limits and conditions set forth for assignee liability in N.J.S.A. 46:10B-27 do not allow a borrower to circumvent the limits and conditions on assignee liability by seeking to obtain separate compensatory and punitive damages against the assignee pursuant to that provision. In any circumstances in which damages are sought against an assignee or purchaser pursuant to N.J.S.A. 46:10B-27, the limits and conditions on such liability apply.

List of Points/Fees Included in Threshold Calculations

Question 24:

A question was raised whether mortgage insurance premiums or private mortgage insurance premiums, commonly referred to as MIP or PMI, are included in the list of points and fees to be considered in the calculation to determine whether the points/fees thresholds are exceeded.

The Department does not consider MIP or PMI as included in the list of points and fees when determining whether the points and fees thresholds are exceeded. The term "points and fees" is defined in N.J.S.A. 46:10B-24 to include all items listed in 15 U.S.C. 1605(a)(1) through (4).

There is no reference to premiums for such insurance indicated within these sections. In addition, section 1605(a)(5) refers to "premium or other charge for any guarantee or insurance protecting the creditor against the obligor's default or other credit loss." Since the Act specifically included sections 1605(a)(1) through (4) and did not include section 1605(a)(5), this type of insurance premium should not be included. It is also worth mentioning that section 1605(a)(4) includes a reference to "credit property insurance" as a type of insurance financed by a creditor. The term credit property insurance is not considered to include MIP or PMI. The term is not a common term in New Jersey, and is not defined or referenced in any other New Jersey statute or regulation.

In other jurisdictions, the term is commonly known as insurance against loss of or damage to personal property covering a creditor's security interest in such property. One Florida statute defines the term as " a limited line of insurance providing coverage on personal property used as collateral for securing a loan or on personal property purchased under an installment sales agreement." A Missouri statute defines it as "insurance against loss of or damage to personal property, covering a creditor's security interest in such property, when such insurance is written as part of a loan or other credit transaction. MIP and PMI are premiums for insurance protecting the creditor against the obligor's default or other credit loss. The credit property insurance is not. For these reasons, the Department does not believe that MIP and PMI should be included in the points and fees calculation to determine whether a loan is a home loan, covered loan, or high cost loan.

11/18/03
Date

/s/ Holly C. Bakke
Holly C. Bakke
Commissioner

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