

BANKING
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF BANKING

Predatory Lending

Adopted New Rules: N.J.A.C. 3:30

Proposed: September 6, 2005 at 37 N.J.R. 3102(a).

Adopted: July 21, 2006 by Steven M. Goldman, Commissioner, Department of Banking and Insurance, in consultation and collaboration with Kimberly S. Ricketts, Director, Division of Consumer Affairs, Department of Law and Public Safety.

Filed: July 24, 2006 as R. 2006 d. 298, **with substantive and technical changes** not requiring additional public notice and comment (see N.J.A.C. 1:30-6.3).

Authority: N.J.S.A. 17:1-8, 17:1-15e and 46:10B-22 et seq. and P.L. 2004 c. 84.

Effective Date: August 21, 2006.

Expiration Date: August 21, 2011.

Summary of Public Comments and Agency Responses:

The Department of Banking and Insurance received written comments from James R. Silkensen, Executive Vice President, New Jersey League of Community Bankers; Nanci L. Weissgold, Esq., of the firm of Kirkpatrick & Lockhart Nicholson Graham, LLP; Mary M. Pfaff, Director, State Government Relations, Federal Home Loan Mortgage Corporation and a three page letter jointly signed by Kenneth Zimmerman, New Jersey Institute for Social Justice; Linda Fisher, AARP; Phyllis Salowe-Kaye, New Jersey Citizen Action; Debbie Goldstein, Center for Responsible Lending and Daryn Martin, Association of Community Organizations for Reform Now (ACORN).

COMMENT: One commenter stated that the proposed new rules implementing the New Jersey Home Ownership Security Act of 2002(the Act) will be helpful in providing guidance on the statute and it supports the proposal.

RESPONSE: The Department appreciates the expression of support for the proposal.

COMMENT: One commenter stated that they believe that the proposal faithfully reflects the substance and intent of the New Jersey Home Ownership Security Act and reinforces the approach taken by the statute.

RESPONSE: The Department appreciates the expression of support for the proposal.

COMMENT: One commenter commended the Department's efforts to support compliance with the New Jersey Home Ownership Act of 2002 through the proposal.

RESPONSE: The Department appreciates the expression of support for the proposal.

COMMENT: One commenter commended the Department's efforts to clarify to the New Jersey Home Ownership Security Act of 2002.

RESPONSE: The Department appreciates the expression of support for the proposal.

COMMENT: One commenter stated they believe that the reaffirmation of the statutory provisions of the New Jersey Home Ownership Security Act of 2002 provisions relating to assignee liability for high cost loans is appropriate and important.

RESPONSE: The Department appreciates the expression of support for the proposal.

COMMENT: One commenter stated that they are pleased that the proposal effectively restates and reinforces the critical provisions relating to assignee liability for home repair and manufactured loans that build upon and effectively codify the decision of the New Jersey Appellate Division in Associates v. Troup, 343 N.J. Super. 254 (App. Div. 2001).

RESPONSE: The Department appreciates the expression of support for the provisions in the proposal relating to assignee liability for home repair and manufactured loans. However the intent of the proposal was not to codify the decision in Associates v. Troup. The Department believes that the case stands on its own merits, as related to the facts presented therein, and notes that the case was not brought under the New Jersey Home Ownership Security Act of 2002, but rather under the Consumer Fraud Act, the law against discrimination, the Fair Housing Act, the Civil Rights Act and the Truth-in-Lending Act. The Department further notes that the decision in the Associates v. Troup case, as reported, only dealt with the entry of summary judgment and judgment of foreclosure for the lender in the Chancery Division. The dismissal of some defenses and counterclaims was upheld by the Appellate Division, but substantial parts of the Chancery Division ruling, including the judgment of foreclosure and the entry of summary judgment on the entire counterclaim in favor of the lender were reversed and the matter was remanded for more discovery and a full trial. Unfortunately, there is no further indication of what transpired subsequent to the Appellate Division's reversal of the judgment of foreclosure and the remanding of substantial parts of the case back to the trial court level.

COMMENT: One commenter stated that the language of proposed N.J.A.C. 3:5-8.2(a)1iii differs from that in the statute. The commenter stated that they are not able to fully assess the significance of the different language but state that they accept the statutory language.

RESPONSE: The Department notes the comment. In addition, upon adoption, the Department is conforming the language in the rule to the language in the statute.

COMMENT: One commenter stated that with regard to proposed N.J.A.C. 3:5-8.2(m), they understand that creditors may seek documentation from borrowers related to whether a borrower was referred. The commenter stated that they believe that such documentation should be assessed on a case by case basis, especially given the well-documented circumstances of coercion or deception. The commenter stated that it is important that the Department determine the reliability and accuracy of any documentation offered given all of the relevant circumstances. The commenter recommended that the second sentence in this proposed section be changed to read “The Department may” rather than “The Department shall,” in the context of the consideration of the documentation.

RESPONSE: The Department recognizes the concerns raised by the commenter but declines to make the change. As part of the Department’s consideration of the documentation mentioned in N.J.A.C. 3:5-8.2(m), the Department will assess any claims of coercion or deception alleged by the borrower as well as other factors. Thus, the reference in the rule to the Department’s consideration of the documentation does not mean that the Department would inevitably consider such documentation to be dispositive on the question of whether it would exercise its administrative authority. Inclusion of the word “shall” in the rule’s text should not be construed as automatically shifting the burden of persuasion to borrowers. The Department does not agree that the documentation should, in all cases, stand on its words or that, in all cases, borrowers have, in effect, waived their claims based upon the documentation.

COMMENT: One commenter stated that they were concerned about the potential unintended consequences of the “requirement” in proposed N.J.A.C. 3:5-8.2(m) that the borrower sign the lender’s documentation of whether referrals may or may not have occurred. The commenter stated that the documentation requirement should not be used to shift the burden of determination to the borrower. It should not be used to suggest that the borrower has waived any claims regarding other parties. The commenter stated to establish these duties it may be useful to add the following to the beginning of N.J.A.C. 3:5-8.2(m): “As part of a lender’s analysis, a lender may wish to obtain an explanation from the borrower regarding any referral or arrangements the borrower may have engaged in to facilitate the loan transaction. Whether or not such information is provided, it remains the lender’s responsibility to assess due diligence with each transaction to determine if referrals took place.”

RESPONSE: The Department declines to make the suggested change. A lender can make signing documentation, such as the explanation mentioned in the comment, a requirement of making the loan. While the Department shall consider a document as described in N.J.A.C. 3:5-8.2(m) when contemplating the exercise of its administrative authority, the Department would also consider any evidence of a failure on the part of a lender to exercise due diligence with respect to whether the borrower was referred by a contractor or seller. See also the Response to the previous Comment.

COMMENT: The commenter also recommended additional language be placed on whatever form a lender uses to obtain such documentation for the purposes of N.J.A.C. 3:5-8.2(m) since, all too often, borrowers are asked to sign a large number of documents in order to receive financing. The commenter stated that frequently borrowers may not understand or have an

opportunity to fully evaluate the significance of the form. The commenter, therefore, recommended that any worksheet expressly state in large type: “By signing this document, the borrower does not waive any rights provided under the New Jersey Home Ownership Security Act, N.J.S.A. 46:10D-22 et seq. or any other relevant State or Federal law.”

RESPONSE: The Department declines to make the change as the Department believes the current rule text is clear. The Department did not intend and would not consider the documentation referenced in N.J.A.C. 3:5-8.2(m) to be a waiver of any rights by a borrower. Rather, it is one indication of whether a referral was made.

COMMENT: One commenter suggested that the Department revise proposed N.J.A.C. 3:5-8.2(a)1 and (m) to remove any language that might be read to suggest that assignees “violate” the Act when purchasing high-cost, manufactured housing or home improvement loans, where the purchasing of such loans might be grounds for initiating administrative enforcement actions against an assignee. The commenter stated that no provision of the Act prohibits the inadvertent purchase of a high-cost loan, yet proposed N.J.A.C. 3:5-8.2(a)1 would have the Department apply the reasonable due diligence safe harbor standard in “any administrative enforcement actions” commenced under the Act against assignees, by assessing whether the assignee exercised “reasonable care” and applied “reasonable scrutiny.” The commenter stated that it is difficult to see how the Department would find opportunities to apply the safe harbor standard in an administrative enforcement action, because an assignee’s inadvertent purchase of a high-cost home loan is not a violation of the Act. Similarly, an assignee’s purchase of a manufactured housing or home improvement loan is not a violation of the Act. Rather, the sole consequence for such purchases is that the borrower may assert claims and defenses against the assignee that

the borrower could assert against the originator or seller. The commenter therefore recommended that the phrase “in any administrative action commenced under N.J.S.A. 46:10B-22 et seq. or this chapter” and the latter reference to “the Department” in the same sentence be removed upon adoption. The commenter also asked the Department to make similar changes to proposed N.J.A.C. 3:5-8.2(m) since a certification from the borrower that he or she was not referred to the creditor by the seller and that the seller did not arrange the loan would be relevant only in connection with proceedings seeking to impose liability on an assignee pursuant to N.J.S.A. 46:10B-27a.

RESPONSE: The Department generally agrees with the commenters’s characterization of the operation of the provision of the rule. However, in certain cases, purchasers or assignees of high-cost loans may be subject to the Department’s regulatory jurisdiction. Furthermore, N.J.S.A. 46:10B-27d specifies certain conduct that would constitute violations of the Act which, if committed by a licensee or other regulated entity, would subject them to administrative sanctions by the Department. Based upon the foregoing, the Department declines to make the suggested changes to N.J.A.C. 3:5-8.2(a)1 and (m) upon adoption.

COMMENT: One commenter suggested that the Department allow the use of loan sampling when an assignee is performing “reasonable due diligence” reviews of loans originated by a lender who makes high-cost home loans. The commenter stated that they do not believe that the mere fact that a lender offers a high-cost home loan program should, standing alone, prevent the use of sampling by the purchaser exercising reasonable due diligence. The commenter noted that the part of proposed N.J.A.C. 3:5-8.2(k) which states “...the assignee being aware of information material to the determination of whether a lender engages in making high-cost home loans...”

appears to suggest that sampling might not be appropriate in connection with the pool of loans originated by a lender that makes high-cost home loans, even if the high-cost home loans are originated through different channels than the loans being purchased, and even if the assignee has conducted a quality control review at the beginning of the relationship and the lender has represented and warranted that there are no high-cost home loans in the pool. The commenter stated that the presence of factors that should cause the assignee to suspect that high-cost home loans are being delivered in violation of its policies ought to trigger the more extensive review set forth at Bulletin 03-15 question 9, and Bulletin 03-30 question 14; however, in the absence of such factors, loan sampling should be considered reasonable due diligence. The commenter suggested that the Department delete the above-noted language and reaffirm its prior statement in the Bulletins that loan sampling is standard, accepted secondary market practice by assignees conducting a reasonable due diligence.

RESPONSE: The Department declines to make the suggested change. The provision is clear that sampling is generally permissible with the size of the sample being impacted by the factors specified.

COMMENT: One commenter stated that they believe strongly in the importance of the New Jersey Home Ownership Security Act. They further stated that the twin goals of the Act were to curb abusive lending practices, especially those involving high-cost loans, and to ensure that New Jerseyans retain access to a broad range of responsible credit. The commenter stated that they are pleased that the Act appears to have succeeded in these goals.

RESPONSE: The Department acknowledges the expression of support for the Act, and appreciates the commenter's belief that the rule is consistent with the goals of the statute.

COMMENT: One commenter noted that proposed N.J.A.C. 3:5-8.2(a)1 states that the Department will presume that an assignee exercised “reasonable due diligence” for the purposes of N.J.S.A. 46:10B-27 if, among other things, the assignee exercised “reasonable care” and applied “reasonable scrutiny.” The commenter was concerned that redefining “reasonable due diligence” as the exercise of reasonable care and the application of reasonable scrutiny will create tremendous uncertainty about what an investor must do in order to take advantage of the due diligence safe harbor. The commenter noted that “reasonable care” is a standard used in many contexts, but most notably associated with tort liability and that in the securities context “reasonable care” is also a standard of care that characterizes the duties that securities underwriters owe investors. The commenter stated that none of the reasonable care articulations have been applied to the mortgage finance context. The commenter also stated that they could not find any authority in New Jersey interpreting or applying a “reasonable scrutiny” standard in the secondary mortgage context. The commenter was concerned that using these transplanted standards in place of “reasonable due diligence” would create more confusion than it resolves. The commenter noted that “due diligence” is a term of art in the market industry and one which the industry has applied for many years. Further, in response to the recent enactment of numerous State anti-predatory lending laws invoking “reasonable due diligence” safe harbors, the industry has adopted compliance procedures consistent with secondary mortgage market due diligence standards. The commenter noted that the Department itself provided helpful clarification, upon which the industry currently relies, by fleshing out reasonable due diligence in Bulletins 03-15 and 03-30. The commenter stated that despite the presence of the statutory language and the above-noted bulletin guidance, the proposed new “exercised reasonable care and applied reasonable scrutiny” standards do not appear to incorporate this prior guidance. The

commenter stated that although “reasonable due diligence” is far from a perfectly clear standard, it is a standard that has a fairly well-developed meaning in the secondary mortgage market and provides concrete guidance to purchasers, borrowers and courts about what innocent investors must do to protect themselves from liability. The commenter is concerned that substituting “reasonable due diligence” with two new word formulations that have no history or defined meaning has the potential to create greater confusion and uncertainty, and based on this, the commenter suggests that N.J.A.C. 3:5-8.2 mirror the statutory language and the Department’s prior guidance.

RESPONSE: The Department agrees with the commenter. Upon adoption, the Department will replace the two proposed tests with “reasonable due diligence” as found in N.J.S.A. 46:10B-27.

COMMENT: One commenter noted that the use of the word “or” at the end of N.J.A.C. 3:5-8.2(a)1ii(2) was inadvertent because, under the statute, in order to qualify for a safe harbor, all three criteria must be met. The commenter noted that the statute uses the word “and” and that this should be used in the eventual rule.

RESPONSE: The Department agrees that the word “or” appears inadvertently and that it should have been an “and.” The Department will make this change upon adoption.

Summary of Changes upon Adoption:

The agency is making the following changes to the proposal upon adoption:

1. Although proposed as N.J.A.C. 3:5, the new rules are being adopted in the Title as N.J.A.C. 3:30.

2. The word “or” at the end of N.J.A.C. 3:30-8.2(a)1ii(2) is being corrected to substitute the word “and” because of a typographical error. The purpose of this portion of the proposed rule was to incorporate the statutory language from N.J.S.A. 46:10B-27(b) into the rule. The statute uses the word “and” because all three listed elements of N.J.S.A. 46:10B-27b, set forth in the proposed rule at N.J.A.C. 3:30-8.2(a)1ii, must be met in order to qualify for that safe harbor exemption. Because this change results in the rule exactly following the statutory language, this change can be made upon adoption without additional public notice and comment.

3. The two tests of reasonable care and reasonable scrutiny proposed in N.J.A.C. 3:30-8.2(a)1iii are being deleted. The Department shares the concern of a commenter that introducing these may cause confusion. The Department is replacing them with the test of “reasonable due diligence” which term is used in N.J.S.A. 46:10B-27b. Because this change results in the rule exactly following the statutory language, this change can be made upon adoption without additional public notice and comment.

Federal Standards Analysis

The Federal Homeownership and Equity Protection Act of 1994 (HOEPA), P.L. 103-325, and the regulations adopted thereunder at 12 CFR 226 provide protections to certain consumers who enter into residential mortgages on their principal dwellings. Some of the protections are prohibiting an increase in the interest rate on a loan upon default, prohibiting loans with balloon payments, prohibiting terms under which more than two periodic payments required under the loan are consolidated and paid in advance from the loan proceeds and, in certain circumstances, extending liability on claims and defenses that the consumer could assert against the creditor to those who purchase or receive an assignment of home loans.

The protections of HOEPA apply if certain points and fees and/or interest rate “thresholds” are exceeded. HOEPA applies to loans where the total points and fees payable by the consumer at or before closing will exceed eight percent of the total loan amount or \$400.00, whichever is greater; or if the annual percentage rate will exceed by more than eight percentage points for first lien loans, or by more than 10 percentage points for subordinate lien loans, the yield on Treasury securities having comparable periods of maturity on the 15th day of the month immediately preceding the month in which the application for credit is received by the creditor.

The adopted new rules set forth similar protections for consumers as does HOEPA in the area of affirmative claims and defenses. In the Act and the adopted new rules, the protections apply to “high cost home loans” which are defined in the Act and in the adopted new rules at N.J.A.C. 3:30-1.3, as those exceeding either the “rate threshold” or the “total points and fees threshold.” The definitions of “rate threshold” in HOEPA and in the adopted new rules are identical. The “total points and fees threshold” in the adopted new rules is lower; therefore, the adopted new rules contain standards that exceed those established by HOEPA. The adopted new rules extend the protections set forth in both HOEPA and the Act to a larger group of loans because of the lower threshold. Although the adopted new rules exceed Federal standards, they implement the Legislature’s clear intent, as set forth in the definition of “high-cost home loan” at N.J.S.A. 46:10B-24, to extend these protections to borrowers who pay total points and fees in excess of the total points and fees threshold specified in that statutory definition. Borrowers on loans that exceed the “total points and fees threshold” in these adopted rules, but would not exceed the HOEPA threshold, enjoy these protections, which are a benefit to this group of borrowers. They are also a potential cost to their respective lenders. Potential costs would be limiting an increase in the interest rate on a loan in the event of default, preventing more than

two loan payments from being paid in advance to the lender from the loan proceeds and preventing the lender or purchaser or assignee of the loan from collecting the loan balance when there has been a violation of the adopted new rules.

The adopted new rules also contain restrictions and/or prohibitions with regard to loans not found in HOEPA. Therefore, the adopted new rules contain standards that exceed those established by HOEPA in addition to those discussed above. Some of these are prohibitions against attempting to avoid the adopted new rules by dividing a transaction into separate parts or any other subterfuge, and providing a six-year time frame from the closing of a high cost home loan to assert against a creditor or subsequent holder or assignee a violation of the Act as an original action and not just as a defense. Although the adopted new rules exceed Federal standards as they contain restrictions and/or prohibitions with regard to loans not found in HOEPA, they carry out the Legislature's clear intent, as set forth at N.J.S.A. 46:10B-27, that consumers whose loans are high-cost home loans be provided with this higher level of protection. This would be a benefit to this group of borrowers and could result in costs being incurred by their respective lenders. The potential costs could include preventing the lender or purchaser or assignee of the loan from collecting the loan balance when there has been a violation of the adopted new rules.

An extension of credit under HOEPA is defined as a consumer credit transaction secured by the consumer's principal dwelling, but does not include a mortgage given in connection with the acquisition or initial construction of a dwelling or a transaction under an open end credit plan. The adopted new rules cover a mortgage given in connection with the acquisition or initial construction of a dwelling and a loan under an open end credit plan. This is a larger group of loans and, therefore, the adopted new rules also contain standards in this area that exceed those

established by HOEPA. Again, these adopted new rules carry out the Legislature's clear intent on this issue, as set forth in the definition of "home loan" at N.J.S.A. 46:10B-24, to afford this additional level of protection to consumers. Borrowers whose mortgage loans are given in connection with the acquisition or initial construction of a dwelling or a transaction under an open-end credit plan would enjoy protections not available to them under HOEPA. This would be a benefit to this group of borrowers and result in potential costs being incurred by their respective lenders. The potential cost could include preventing a lender or purchaser or assignee of the loan from collecting the loan balance when there has been a violation of the adopted new rules.

The adopted new rules at N.J.A.C. 3:30-8.1 permit affirmative claims and defenses against creditors, assignees or holders in any capacity where the home loan was made, arranged or assigned by a person selling either a manufactured home or home improvements to the dwelling of a borrower or was made by or through a creditor to whom the borrower was referred by such seller. This is a broader approach than that taken in HOEPA, which does not provide for such liability. Therefore, these adopted new rules also contain standards that exceed those established by HOEPA. Although they exceed Federal standards, the adopted new rules implement the Legislature's clear intent, as set forth at N.J.S.A. 46:10B-27a, to provide this higher level of protection to consumers who receive such loans. Borrowers who qualify under the rules would enjoy the protections of N.J.A.C. 3:30-8.1 set forth earlier in this paragraph. This would be a benefit to this group of borrowers and a potential cost to their respective lenders. The potential cost could be preventing the lender or purchaser or assignee of the loan from collecting the loan balance when there has been a violation of the adopted new rules.

Lastly, certain definitions contained in 12 U.S.C. §1841, 15 U.S.C. §§1601, 1602(aa), and 1605, 42 U.S.C. §5401, HOEPA Pub. L. 103-325, 12 CFR 226 and 16 CFR 433 are incorporated by reference in the adopted new rules, making the requirements of the adopted new rules with regard to the scope of these definitions the same as those imposed by Federal standards.

Full text of the adopted new rules follows (additions to proposal indicated in boldface with asterisks ***thus***; deletions from proposal indicated in brackets with asterisks *[thus]*):

CHAPTER *[5]* ***30***
 PREDATORY LENDING

[3.5] ***3:30***1.1 (No change in text from proposal.)

[3.5] ***3:30***-1.2 Scope

This chapter shall apply to all creditors and borrowers as defined in N.J.A.C. 3:*[3.5]*

3:30-1.3.

[3.5] ***3:30***-1.3 (No change in text from proposal.)

[3.5] ***3:30***-5.1 (No change in text from proposal.)

[3.5] ***3:30***-8.1 (No change in text from proposal.)

[3.5] ***3:30***-8.2 Purchaser and assignee liability under N.J.S.A. 46:10B-27

(a) Pursuant to N.J.S.A. 46:10B-27b, any person who purchases or is otherwise assigned a high-cost home loan shall be subject to all affirmative claims and any defenses with respect to the loan that the borrower may assert against the original creditor or broker of the loan; except that the liability thereunder shall not arise if the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising reasonable due diligence could not determine that the loan was a high-cost home loan.

1. In any administrative action commenced under N.J.S.A. 46:10B-22 et seq. or this chapter, it shall be presumed by the Department that a purchaser or assignee of a high cost home loan has exercised such due diligence if the purchaser or assignee demonstrates by a preponderance of the evidence that it:

i. (No change from proposal.);

ii. Requires by contract that all sellers or assignors of home loans represent and warrant to the purchaser or assignee that either:

(1) (No change in proposal.)

(2) That the seller or assignor is a beneficiary of a representation and warranty from a previous seller or assignor to that effect; *[or]* **and***

iii. Exercises reasonable *[care and applies reasonable scrutiny]* **due diligence*** at the time of the purchase or assignment of home loans or within a reasonable period of time thereafter, which *[care and scrutiny are]* **due diligence is*** intended by the purchaser or assignee to prevent it from purchasing or taking assignment of any high-cost loan.

(b) – (m) (No change from proposal.)

[3.5] **3:30***-9.1 (No change from proposal.)

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