

Memorandum

To: MBA's Regulatory Compliance Conference
"Secondary Market Developments"
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RE: Updated Memorandum Regarding New York Anti-Predatory Lending Laws

This memorandum updates our previous memoranda summarizing New York anti-predatory lending statute, Section 6-l of the Banking Law (the "Statute") and the interpretive regulations contained in Part 41 of the General Regulations of the Banking Board ("Part 41"). ***This updated memorandum addresses the salient provisions of Senate Bill 8143-A (2008) ("SF 8143"), which was signed into law by New York Governor David Paterson on August 5, 2008, and makes a number of significant changes to New York law.*** Among other provisions, SB 8143:

1. Amends the Statute by imposing additional restrictions and disclosures on high cost home loans. The majority of these amendments will become effective to loans closed on and after September 1, 2008;
2. Imposes restrictions and disclosure requirements on a new category of "subprime home loans" closed on and after September 1, 2008. These provisions include prohibitions on refinancing such loans without a tangible net benefit to the borrower and requirements to verify the borrower's ability to repay;
3. Effective to foreclosure actions commenced on and after September 1, 2008, imposes a new disclosure requirement and ninety-day waiting period with respect to the foreclosure of high-cost home loans, subprime home loans, and non-traditional home loans. *Please note that the definition of a "subprime home loan" for the purposes of the foreclosure requirements is different than the definition for purposes of the substantive restrictions on subprime home loans discussed above;*
4. Requires a mandatory settlement conference before a creditor may foreclose a high cost home loan, subprime home loan, or non-traditional home loan closed between January 1, 2003 and September 1, 2008. ***This requirement became effective immediately upon the Governor's signature on August 5, 2008;***

5. Effective September 1, 2008, amends existing foreclosure disclosures required to be delivered with respect to all residential mortgage loans;
6. Amends Article 12-D of the Banking Law (the "Licensing Act") to require mortgage servicers to register with the New York Banking Department (the "Department") beginning on July 1, 2009;
7. Effective to residential mortgage loans closed on or after September 1, 2008, imposes a duty of good faith on licensed mortgage brokers and prohibits mortgage lenders and mortgage brokers from unduly influencing real estate appraisers;
8. Enacts a new Residential Mortgage Fraud Act as Article 187 of the New York Penal Law (the "Fraud Act"), which will become effective on November 1, 2008; and
9. Enacts a new Foreclosure Rescue Act as Section 265-b of the Real Property Law (the "Rescue Act"), which will become effective on September 1, 2008.

As before, a violation of the ***high cost home loan provisions*** can have significant consequences for a secondary market assignee of a high cost home loan. The Statute provides that upon a finding by a court of an *intentional* violation by the lender of the high-cost home loan provisions, or regulations promulgated thereunder, the home loan agreement will be rendered void. Further, upon a judicial finding that a high-cost home loan violates any of the high-cost home loan provisions, whether such violation is raised as an affirmative claim or as a defense, the loan transaction may be rescinded. This right of rescission may be invoked by the borrower as a defense to the holder's affirmative claim without time limitation. ***The Statute also provides that in any action by an assignee to enforce a loan against a borrower in default more than sixty days or in foreclosure, a borrower may assert against an assignee any claims in recoupment and defenses to payment under the high-cost home loan provisions and with respect to the loan, without time limitation, that the borrower could assert against the original lender of the loan.***

Any person found by a preponderance of the evidence to have violated the ***subprime home loan provisions*** will be liable to the borrower for actual damages and, in a foreclosure action, reasonable attorney fees. A borrower may also be granted injunctive, declaratory, and other equitable relief as the court deems appropriate. A violation of the subprime home loan provisions may be asserted by a borrower as a defense in any action by a lender ***or assignee*** to enforce a loan against a borrower in default more than sixty days or in foreclosure. ***Please note that, unlike the high cost home loan provisions, the subprime home loan provisions do not otherwise appear to impose any civil liability on an assignee of a subprime home loan with respect to the compliance failures of an originator. However, the equitable relief authorized by SB 8143 may conceivably encompass loan rescission or loan modification, which could impact a secondary market holder of a subprime home loan.***

SB 8143 does not contain explicit penalties associated with a violation of the foreclosure restrictions applicable to high cost home loans, subprime home loans, and non-traditional home loans. However, it is likely that a compliance failure would impede a creditor's ability to enforce its rights under the credit agreement and proceed to a foreclosure judgment. While SB 8143 provides for a range of civil and criminal liability associated with violations of the Licensing Act, the Fraud Act, and the Rescue Act, none of these statutes appear to have a significant impact on secondary market purchasers of residential mortgage loans.

I. HIGH COST HOME LOAN AND SUBPRIME HOME LOAN PROVISIONS

New York first enacted substantive restrictions on high cost home loans in a stand-alone Part 41, which became effective to loans closed on or after October 1, 2000. Subsequently, the New York legislature enacted statutory restrictions applicable to such loans. The Statute became effective with respect to loans originated on or after April 1, 2003. On May 5, 2003, the Department substantially revised Part 41 to conform to the Statute (the "May 5, 2003 Amendments").¹ We have summarized below the salient provisions of the Statute and the *revised* Part 41.²

This memorandum also addresses a number of additional conforming amendments made to Part 41 since the enactment of the Statute. In 2003, the Department amended Part 41 to conform it to the Statute by requiring that APR thresholds be calculated without regard to any lower initial or introductory rates (the "Introductory Rate Amendments"). The Introductory Rate Amendments became effective on August 20, 2003, for first mortgages and September 12, 2003, for subordinate mortgages. Thereafter, the Department made several additional amendments to Part 41 which became effective March 8, 2004, as noted below (the "2004 Amendments").

A. High Cost Home Loan Provisions

1. Definitions

a. High Cost Home Loan

The limitations and prohibited terms and practices apply to lenders³ and brokers⁴ making or arranging "high cost home loans." A "high cost home loan" is defined as a residential

¹ For those loans originated between April 1, 2003, the effective date of the Statute, and May 4, 2003, regulators have stated that, in addition to the Statute, the original Part 41 would continue to apply except for those provisions which conflict with the Statute. For loans originated on and after May 5, 2003, the revised Part 41 and the Statute would apply. Please note that each amended version of Part 41 applies only to the extent it does not conflict with the Statute.

² For a discussion of Part 41 as it existed before the enactment of the statute, please refer to our memorandum entitled, "*Summary of New York State Banking Department Proposed Regulation Part 41, Restrictions and Limitations on High Cost Home Loans*" (May 18, 2000).

³ Under the Statute and the May 5, 2003 Amendments, a "lender" is defined to include any "mortgage banker" or "exempt organization" as those terms are defined under the Licensing Act. The License Act defines a "mortgage banker" as a person licensed to directly or indirectly advance funds, offer to advance funds, or make a

mortgage loan, including an open-end line of credit, but not a reverse mortgage transaction, in which:

1. The principal amount of the loan does not exceed *the lesser* of:
 - a. The conforming loan size limit for a comparable dwelling as established from time-to-time by FNMA; *or*
 - b. \$300,000;

Please note that effective October 14, 2007, for applications received on or after that date, this portion of the “high cost home loan” definition was amended so that the principal amount of the loan may not exceed the conforming loan size limit for a comparable dwelling as established from time-to-time by FNMA. The \$300,000 limitation no longer applies.

2. The borrower is a natural person and the debt is incurred by the borrower primarily for personal, family or household purposes;
3. The loan is secured by a mortgage or deed of trust on real estate upon which there is located or will be located a structure or structures, intended principally for occupancy of from one to four families, which is or will be occupied by the borrower as his/her principal dwelling⁵;

commitment to advance funds to an applicant for a mortgage loan or a mortgagor as a mortgage loan. An “exempt organization,” in turn, means any insurance company, banking organization, foreign banking corporation licensed by the Department or the Comptroller of the Currency to conduct business in New York, national bank, federal savings bank, federal savings and loan association, federal credit union, or any bank, trust company, savings bank, savings and loan association, or credit union organized under the laws of any other state, or any instrumentality created by the United States or any state with the power to make mortgage loans. The term may also include subsidiaries of such organizations, subject to regulations promulgated by the Department.

The May 5, 2003 Amendments further clarified that the mortgage banker or exempt organization to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract, will be deemed to be the lender. Previously, a lender was defined as an individual or entity that originated more than one high cost home loan. In an Interpretive Letter issued on March 2, 2006, the Department clarified that the word “lender” does not include private parties who make fewer than five mortgage loans per year, but does include those parties that make five or more mortgage loans during the year.

⁴ The term “mortgage broker” means a person licensed to engage in the business of soliciting, processing, placing or negotiating mortgage loans for others, or offering to solicit, process, place or negotiate mortgage loans for others. “Soliciting, processing, placing or negotiating a mortgage loan” means for compensation or gain, either directly or indirectly, accepting or offering to accept an application for a mortgage loan, assisting or offering to assist in the processing of an application for a mortgage loan, soliciting or offering to solicit a mortgage loan on behalf of a third party or negotiating or offering to negotiate the terms or conditions of a mortgage loan with a lender on behalf of a third party. The term also includes a mortgage banker when the mortgage banker solicits, processes, places, or negotiates a mortgage loan for others.

⁵ In an Interpretive Letter dated October 13, 2004, the Banking Department concluded that Part 41 does not apply to mobile or manufactured homes.

4. The property is located in New York state; *and*
5. The loan meets any of the enumerated thresholds.

Under the May 5, 2003 Amendments, these thresholds were amended to comport with those set forth in the Statute. As revised, the thresholds for “high cost home loans” are:

1. For first mortgages, the annual percentage rate (“APR”)⁶ at consummation, including without limitation any points and/or bona fide discount points,⁷ will exceed by *more than 8%* the yield on United States Treasury securities having comparable periods of maturity to the loan maturity measured as of the fifteenth day of the month immediately preceding the month in which the application for the residential mortgage loan is received by the lender (the “Treasury Yield”);⁸ *or*
2. For junior mortgages, the APR at consummation, including without limitation any points and/or bona fide discount points, will exceed by *9% or more* the Treasury Yield; *or*
3. The total points and fees payable exceed:
 - a. 5% of the total loan amount⁹ if such amount is \$50,000 or more; *or*

⁶ As before, and as under the Statute, the APR is determined under the Truth-in-Lending Act, 15 U.S.C. § 1601 *et seq.*, and accompanying regulations. As under TILA, the APR thresholds were to be calculated under the May 5, 2003 Amendments to include any lower introductory rate. ***However, under the Introductory Rate Amendments, if the terms of the loan offer any initial or introductory rate that is lower than the rate that will apply thereafter, the APR for the purposes of the high cost thresholds should be calculated using only the rate that applies after the introductory period. The Introductory Rate Amendments became effective August 20, 2003 for first mortgage loans, and September 12, 2003 for subordinate mortgage loans.***

⁷ “Bona fide loan discount points” means loan discount points knowingly paid by the borrower and funded through any source for the purpose of reducing, and which in fact result in a bona fide reduction of, the interest rate or time-price differential applicable to the loan, provided the amount of the interest rate reduction purchased by the discount points is reasonably consistent with established industry norms and practices for secondary mortgage market transactions. There is a presumption that a point is a bona fide loan discount point if it reduces the interest rate by a minimum of 25 basis points, or 1/4 of a point, provided all other terms of the loan remain the same.

⁸ In determining the applicable yield on United States Treasury Securities, Part 41 specifies that the lender may use the yield published by the Department on its website or the yield as determined by reference to 12 C.F.R. § 226.32(a), provided that the lender notes in the loan file which yield is being utilized and uses that yield consistently. Part 41 also states that lenders may rely upon and use the Treasury Yield information from its website until ninety days after the Department publishes new information on its website.

⁹ The definition of “total loan amount” was revised by the May 5, 2003 Amendments to conform to the Statute. As amended, “total loan amount” means the principal of the loan minus those points and fees that are included in the principal amount. Previously, “total loan amount” had been determined under Regulation Z. In an Interpretive Letter dated September 17, 2004, the Department clarified that at closing when funds are distributed directly from Thacher Proffitt & Wood LLP

- b. 6% of the total loan amount if such amount is \$50,000 or more and the loan is a purchase money loan guaranteed by the Federal Housing Administration or the Veterans Administration; or
- c. The greater of 6% of the total loan amount or \$1,500, if such amount is less than \$50,000.

Bona fide loan discount points payable by the borrower in connection with the loan transaction may be excluded from the calculation of the total points and fees payable by the borrower for purposes of this threshold if:

1. Such discount points do not exceed two points and only if the loan's interest rate that is to be discounted is not greater than 1% above the Treasury Yield¹⁰; *or*
2. Such discount points are funded directly or indirectly through a grant from a federal, state or local government agency, or a not-for-profit organization having a taxable status under section 501(c)(3) of the Internal Revenue Code.

Unlike the federal Home Ownership and Equity Protection Act ("HOEPA"), purchase money loans are high cost home loans if they meet the requisite definitional provisions.

Part 41 further specifies that any product offered as a mortgage loan by an instrumentality of the United States or of any state, such as loan products offered by the State of New York Mortgage Agency, will be exempt from Part 41.

b. Points and Fees

The May 5, 2003 Amendments also revise the definition of "points and fees" to comport with the definition set forth in the Statute. As amended, "points and fees" means:

1. All items listed in 15 U.S.C. § 1605(a)(1) through (4),¹¹ except interest or time-price-differential;

the loan proceeds on checks drawn from the loan principal at the request of the borrower to pay the lender or other parties for fees associated with the loan, these fees *are not required* to be deducted from the total loan amount.

¹⁰ An Interpretive Letter issued on October 27, 2005 by the Department clarifies for purposes of this calculation that the Treasury yield should be measured as of the fifteenth day of the month immediately preceding the month in which the application is received *by the lender*. Unlike Part 41.1(e)(6)(i) and Part 41.1(e)(6)(ii), this section leaves out the phrase "by the lender," but the Department notes that this phrase should be read into the calculation in this section on bona fide discount points. The Department states that in the case of a true broker, then the date received is when the lender physically receives the application. However, in the case where an agent of the lender receives the application, the date of receipt will be imputed to the lender under the principles of agency law.

¹¹ 15 U.S.C. § 1605(a)(1) through (4) includes the following items: (1) any amount payable under a point, discount, or other system or additional charges; (2) a service or carrying charge; (3) a loan fee, finder's fee, or similar charge; and (4) a fee for an investigation or credit report.

2. All charges for items listed under 12 C.F.R. § 226.4(c)(7),¹² but only if the lender receives direct or indirect compensation in connection with the charge or the charge is paid to an affiliate of the lender;¹³ and
3. All compensation paid directly or indirectly to a mortgage broker not otherwise included above.¹⁴

The May 5, 2003 Amendments did not include the cost of single premium credit insurance in its definition of “points and fees.” However, regulators had indicated that because the Statute considers such insurance to constitute “points and fees,” such costs *should nevertheless be included* in the definition. Regulators had assured us that Part 41 would be

¹² 12 C.F.R. § 226.4(c)(7) states:

The following fees in a transaction secured by real property or in residential mortgage transaction, if the fees are bona fide and reasonable in amount:

- (i) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes;
- (ii) Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents;
- (iii) Notary, and credit report fees;
- (iv) Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest infestation or flood hazard determinations;
- (v) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

¹³ The Department has also clarified on its website that following charges in the making of a mortgage loan are included within the definition of points and fees for a high cost home loan under the Statute, if the lender, or an affiliate of the lender, receives any direct or indirect compensation from such charges:

- (i) Any amount charged as a point, a discount, or any other system of charges;
- (ii) The service or carrying charge;
- (iii) A loan fee, finder’s fee, or similar charge;
- (iv) Any fee for an investigation or credit report;
- (v) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes;
- (vi) Fees for preparing loan-related documents, such as deeds, mortgages, and re-conveyance or settlement documents;
- (vii) Notary fees;
- (viii) Property appraisal fees or fees for inspections to assess the value or condition of the property if the services are performed prior to closing, including fees related to pest infestation or flood hazard determinations;
- (ix) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

¹⁴ As noted in our memorandum summarizing the Statute, regulators have indicated that *yield spread premiums would be included in the definition of “points and fees.”* Note that in an Interpretive Letter issued on September 3, 2004, the Banking Department clarified that yield spread premiums are included in points and fees for purposes of the Revised Part 41 and the Statute, however they were ***not included*** in points and fees under the Original Part 41.

amended to correct this oversight. *The 2004 Amendments did so, revising the definition of “points and fees” to include any payments to finance premiums for any credit life, credit disability, credit unemployment, or credit property¹⁵ insurance, or any other life or health insurance, or any debt cancellation or suspension agreement or contract, whether or not interest is charged.* Payments for premiums for any credit life, credit disability, credit unemployment, or credit property insurance, or any other life or health insurance, or any debt cancellation or suspension agreement or contract calculated and paid on a monthly basis *will not* constitute “points and fees” for purposes of Part 41 or the Statute.

The 2004 Amendments also clarified that any payments for a mortgage recording tax do not constitute “points and fees.”

In an Interpretive Letter issued on June 13, 2006, the Department clarified that a seller/lender lump sum credit in favor of the borrower *cannot be used* to reduce the points and fees calculation under Part 41. Since a general lump sum credit cannot be tied directly to any particular points and fees, the Department will consider points and fees to have been charged regardless of any general lump sum credit. However, the Department goes on to clarify that if an itemized credit in favor of the borrower is given, it can be used to reduce the points and fees for purposes of Part 41. The Department elaborated that since an itemized credit is tied clearly to a component in the points and fees calculation, the itemized credit should not be considered to be charged to the borrower and includable for the points and fees high cost calculation.

2. Limitations and Prohibited Practices for High Cost Home Loans

Under Part 41, a high cost home loan is subject to the following limitations:

1. **No call provisions.** No high cost home loan may contain a provision that permits the lender, in its sole discretion, to accelerate the indebtedness. However, the May 5, 2003 Amendments specified that this provision does not prohibit acceleration of the loan in good faith due to either a bona fide default or other failure to abide by the material terms of the loan, or pursuant to a due-on sale provision, or pursuant to some other provision of the loan agreement unrelated to the payment schedule such as bankruptcy or receivership. The Statute merely indicates that the loan may be accelerated if due to the borrower’s failure to abide by the material terms of the loan.
2. **No balloon payments.** No high cost home loan may contain a scheduled final payment that is more than twice as large as the average of earlier scheduled payments, unless such balloon payment becomes due and payable at least fifteen

¹⁵ The 2004 Amendments stated that credit property insurance does not include insurance coverage for fire, miscellaneous property, or water damage, as defined pursuant to Section 1113 of the Insurance Law, placed upon the mortgaged property. Further, payments for title insurance premiums and payments for premiums for insurance required by the lender which guarantee payment of all or part of the outstanding principal loan amount upon the default of the borrower (for example, private mortgage insurance, the Federal Housing Administration mortgage insurance premium fee, the Veterans Administration funding fee, or any fee charged by Fannie Mae or Freddie Mac that provides for a similar guarantee) are not considered “points and fees.”

years after the loan's origination. Previously, Part 41 had set the time limitation at seven years. Part 41 specifies that the foregoing does not apply when the payment schedule is adjusted to the seasonal or irregular income of the borrower or if the purpose of the loan is a bridge loan connected with the acquisition or construction of a dwelling intended to become the borrower's principal dwelling. Further, Part 41 specifies that the foregoing will not apply to open-end high cost home loans. Please note that this language regarding bridge loans is not present in the Statute.

3. **No negative amortization.** Part 41 and the Statute state that notwithstanding any statute of regulation to the contrary, no high cost home loan may contain a payment schedule with regular periodic payments that cause the principal balance to increase. However, Part 41 also clarifies that this will not prohibit negative amortization as a consequence of a temporary forbearance sought by the borrower and that this provision will not apply to open-end high cost home loans. *Effective September 1, 2008, SB 8143 incorporates the Part 41 clarification into the text of the Statute and further provides that negative amortization will be considered to exist if the borrower is given the option to make regular periodic payments that cause the principal balance to increase, even if the borrower is also given the option to make regular periodic payments that do not cause the principal balance to increase.*
4. **No increased interest rate.** No high cost home loan may contain a provision which increases the interest rate after default. This provision does not apply to interest rate changes in a variable rate loan that is otherwise consistent with the provisions of the loan documents provided that the change in the interest rate is not triggered by the event of default or the acceleration of the indebtedness.
5. **Limitation on advance payments.** No high cost home loan may include terms under which more than two periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to the borrower.
6. **No oppressive mandatory arbitration clauses.** No high cost home loan may be subject to a mandatory arbitration clause that is oppressive, unfair, unconscionable, or substantially in derogation of the rights of consumers. Part 41 clarifies that arbitration clauses that comply with the standards set forth in the Statement of Principles of the National Consumer Dispute Advisory Committee¹⁶ in effect as of October 1, 2000 will be presumed not to violate the foregoing.
7. **No Prepayment Penalties.** *Effective September 1, 2008, no prepayment fees or penalties may be charged or collected on a high cost home loan. Any such fee or penalty will be unenforceable.*

¹⁶ <http://www.banking.state.ny.us/41.htm>

8. **No lending without due regard to repayment ability.** A lender or mortgage broker may not make or arrange a high cost home loan unless the lender reasonably believes at the time the loan is consummated that the borrower or borrowers¹⁷ (when considered collectively in the case of multiple borrowers) will be able to make the scheduled payments to repay the obligation based on a consideration of their current and expected income, current obligations, employment status, and other financial resources (other than the borrower's equity in the dwelling which secures repayment of the loan), as verified by detailed documentation of all sources of income and corroborated by independent verification.

Part 41 clarifies that there is a rebuttable presumption that the loan was made with due regard to repayment ability if the lender demonstrates that at the time the high cost home loan is consummated, the borrower's scheduled monthly payments¹⁸ *do not exceed 50%* of the borrower's monthly gross income as verified by the credit application, the borrower's financial statement, a credit report, financial information provided to the lender by or on behalf of the borrower, or any other reasonable means, and the lender follows the residual income guidelines established in 38 C.F.R. § 36.4337(e) and VA form 26-6393.¹⁹ Part 41 also states that these residual income guidelines must be published on the New York Department website and that lenders may rely upon and use such information until ninety days after the Department publishes new information on its website.

The May 5, 2003 Amendments further clarified that a borrower's repayment ability will be presumed "corroborated by independent verification" for the foregoing purposes if the borrower's income, employment status, obligations and other financial resources are verified by documents prepared by persons or entities having no direct relationship with the lender or relationship with the borrower, other than an employment, debtor-obligor, or fiduciary relationship, or by governmental documents, such as an income tax return. For purposes of determining monthly income, only the income of the borrower(s) may be considered.

¹⁷ Under the May 5, 2003 Amendments, all references to the "borrower" in this section had instead referred to the "obligor." The 2004 Amendments clarified that it is the repayment ability of the "borrower," as defined, that must be considered. Note that the 2004 Amendments define "borrower" to include a co-borrower or co-signer, but not a guarantor.

¹⁸ Part 41 states that "scheduled monthly payments" means minimum sums required to be paid with respect to all of the borrower's debts that are reported on a nationally recognized consumer credit bureau report and the monthly mortgage payment due under the high cost home loan (ignoring any reduction arising from a lower introductory rate) plus one twelfth of the annualized cost of real estate tax and insurance premium payments during the immediately preceding twelve months. Scheduled monthly payments do not include any debts that are consolidated with or paid off by the high cost home loan.

¹⁹ VA Form 26-6393 may be viewed at <http://www.vba.va.gov/pubs/homeloanforms.htm>

9. **Financing of points and fees.** The amended Part 41 expands on the Statute's prohibition against the financing of points and fees in excess of 3% to state that in making a high-cost home loan, a lender may not require a borrower to directly or indirectly finance any portion of the points and/or fees in an amount that exceeds 3% of the principal amount of a closed end high cost home loan, or of the maximum line of credit amount for open end high cost home loans, for loans other than refinancings.²⁰ In accordance with the definition of "points and fees" under the Statute, the May 5, 2003 Amendments removed language from Part 41 that allows the exclusion of appraisal fees, credit report fees, mortgage recording tax, fire and miscellaneous property insurance, title report and title insurance charges from the foregoing prohibition.

For refinancings, a lender may not finance such points or fees in an amount that exceeds 3% of the additional proceeds²¹ received by the borrower in connection with the refinancing.

Further, in making a high cost home loan, a lender may not finance voluntary credit, disability, unemployment and/or life insurance. The 2004 Amendments clarified that this prohibition applies whether or not interest is charged. A lender may also not directly or indirectly finance any prepayment fees or penalties payable by the borrower in a refinancing transaction if the lender or an affiliate is the originator of the loan being refinanced.

10. **Refinancing of existing high cost home loans.** The May 5, 2003 Amendments also amended Part 41 to include the Statute's prohibition against charging a borrower points and fees in connection with a high cost home loan if the proceeds of the high cost home loan are used to refinance an existing high cost home loan held by the lender or its affiliate. The May 5, 2003 Amendments further clarified that *in all other instances*, a lender may not charge a borrower points and fees in connection with a high cost home loan if the proceeds of the high cost home loan are used to refinance an existing high cost home loan and the last financing was within two years of the current refinancing. This does not, however, prohibit a lender from charging points and fees in connection with any additional proceeds²² received by the borrower in connection with the refinancing, provided that the points and fees charged on the additional sum reflect the lender's typical point

²⁰ Note that under the May 5, 2003 Amendments, the lender would have been prohibited from financing points and fees in excess of this amount, even at the borrower's request. However, the 2004 Amendments removed this language.

²¹ Part 41 specifies that for these purposes, "additional proceeds" for a closed end loan is the amount over and above the current principal balance of the existing home loan. For an open end loan, "additional proceeds" is the amount by which the line of credit on the new loan exceeds the current principal balance of the existing home loan.

²² Again, "additional proceeds" is defined in the same way as under the "Financing of points and fees" provision. *See id.*

and fee structure for high cost refinance loans. *Significantly, under the May 5, 2003 Amendments, Part 41 had stated that the foregoing provision only applies in those instances in which the new high cost home loan involved the use of a mortgage broker. However, this exemption was removed by the 2004 Amendments.*

11. **No modification or deferral fees.** Reflecting the Statute, the May 5, 2003 Amendments stated that a lender may not charge a borrower any fees to modify, renew, extend, or amend a high cost home loan or defer any payment due under a high cost home loan if, after the modification, renewal, extension or amendment, the loan is still a high cost loan or, if no longer a high cost home loan, the APR has not been decreased by at least 2%. For the foregoing purposes, fees do not include interest that is otherwise payable and consistent with the provisions of the loan documents. Further, this restriction does not prohibit a lender from charging points and fees in connection with any additional proceeds received by the borrower in connection with the modification, renewal, extension or amendment (over and above the current principal balance of the existing high cost home loan) provided that the points and fees charged on the additional sum reflect the lender's typical point and fee structure for high cost home loans. The foregoing does not apply if the existing high cost home loan is in default or is sixty or more days delinquent and the modification, renewal, extension, amendment or deferral is part of a work-out process.
12. **Restrictions on home improvement contracts.** A lender may not pay a contractor under a home improvement contract from the proceeds of a high cost home loan other than:
 - a. By an instrument payable to the borrower or jointly to the borrower and the contractor; or
 - b. At the election of the borrower, through a third-party escrow agent in accordance with terms established in a written agreement signed by the borrower, the lender, and the contractor prior to the disbursement.
13. **No refinancing of special mortgages.** As in the Statute, the May 5, 2003 Amendments stated that no lender making a high cost home loan may refinance an existing mortgage loan that is a special mortgage originated, subsidized or guaranteed by or through a state, tribal or local government, or nonprofit organization, which either bears a below-market interest rate at the time of origination, or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income, are limited to a percentage of income, or where no payments are required under specified conditions, and where, as a result of the refinancing, the borrower will lose one or more of the benefits of the special mortgage, unless the lender is provided prior to loan closing documentation by the lender who originally made the special mortgage or by a housing counselor approved by the U.S. Department of Housing and Urban Development ("HUD")

that a borrower has received home loan counseling in which the advantages and disadvantages of the refinancing has been received.

Please note that under SB 8143, this prohibition also applies to mortgage brokers arranging high cost home loans originated on or after September 1, 2008.

14. **No financing of single premium insurance or other products unrelated to the loan.** The May 5, 2003 Amendments provided that no lender or affiliate may finance single premium credit life, accident, health, disability, or loss of income insurance, or any other life or health insurance premiums, in connection with a high cost home loan, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract. However, insurance premiums or payments calculated and paid on a monthly basis are not considered so financed.

Effective September 1, 2008, SB 8143 also prohibits lenders and their affiliates from financing any product or service that is not necessary or related to the high-cost home loan, such as auto club memberships or credit report monitoring. This prohibition does not cover fees paid to the lender, broker, or closing agent; fees related to the recording of the mortgage; title insurance; or other settlement fees.

15. **No abusive yield spread premiums.** *Effective September 1, 2008, SB 8143 provides that a mortgage broker's compensation in connection with a high cost home loan may be paid as direct compensation from the lender, direct compensation from the borrower, or a combination of the two. A borrower may use a yield spread premium to offset any upfront costs by accepting a higher interest rate. However, if the borrower chooses this option, any compensation from the lender that exceeds the exact amount of total compensation owed to the broker as disclosed in the disclosure described below in Section I(A)(4)(f) of this memorandum must be credited to the borrower. A mortgage broker may accept a lesser amount.*
16. **Mandatory Escrow of Taxes and Insurance.** *SB 8143 provides that in any high cost home loan made after July 1, 2010, the lender must require and collect the monthly escrow of property taxes and insurance. A borrower may waive this escrow requirement by notifying the lender in writing after one year from consummation of the loan. This requirement does not apply to a subordinate lien when the taxes and insurance are escrowed through another home loan. It also does not apply if the borrower can demonstrate a record of twelve months of timely payments of taxes and insurance on a previous home loan.*²³

²³ Note that this exemption may be of limited usefulness, considering that unescrowed taxes and insurance are normally paid on an annual, not a monthly, basis.

17. **No Teaser Rates.** *No high cost home loan closed on or after September 1, 2008, may include an initial or introductory rate with a duration of fewer than six months.*

3. Additional Requirements in Making a High Cost Home Loan

Part 41 requires the following in making a high cost home loan:

1. **Reporting Credit Information.** The lender must report both the favorable and unfavorable payment history of the borrower to a nationally recognized consumer credit bureau at least annually during such period as the lender holds or services the loan.
2. **Reporting to the Department.** Mortgage brokers and lenders that make ten or more high cost home loans per year must report to the Department annually, on or before March 31st in each year, the names and addresses of the three home improvement contractors, the three consultants and the three attorneys who obtain the largest number of payments directly from the proceeds of high cost home loans made or brokered by the lender or mortgage banker. They must also provide the names and addresses of any home improvement company that is an affiliate. This provision does not apply, however, to attorneys in their capacity as closing attorneys for lenders.

4. Disclosure Requirements

Part 41 requires the following disclosures to be provided in connection with a high cost home loan. Please note that where there is more than one borrower on a high cost home loan, and Part 41 requires a notice to be given or a signature obtained, such requirement will be deemed satisfied by the delivery or placing in the mail to, or obtaining the signature of, any borrower who is primarily liable on the high cost home loan.

a. Counseling Disclosure and List of Counselors

Part 41 states that a lender or mortgage broker must deliver, place in the mail, fax or electronically transmit the following notice in at least 12-point type to the borrower at the time of application, *which disclosure must be on a separate form*:

You should consider financial counseling prior to executing loan documents. The enclosed list of counselors is provided by the New York State Banking Department.

If the lender or broker does not know whether the borrower's application is a high cost home loan application, the disclosure must be made as soon as the lender determines that it is a high cost home loan application. In the event of a telephone application, the disclosure must be

made immediately after receipt of the application by telephone. In order to use an electronic transmission, the lender or broker must first obtain either written or electronically transmitted permission from the borrower. A list of approved counselors, available from the Department, must be provided to the borrower by the lender or the mortgage broker at the time that this disclosure is given. The lender or mortgage broker may provide to the borrower the entire list of counselors or those portions of the list which pertain to both the geographic area in which the borrower resides and any adjacent area or areas. Part 41 specifies that lenders may rely upon and use the list until ninety days after the Department publishes new information on its website.

b. Consumer Caution Notice

Further, reflecting the Statute, Part 41 states that *within three days* after determining that the loan is a high cost home loan, *but no less than ten days before closing*, a lender or mortgage broker may not make or arrange a high cost home loan unless either the lender or the mortgage broker has delivered to the borrower in writing, either placed in the mail, faxed or electronically transmitted, the following notice in at least twelve-point type:

CONSUMER CAUTION AND HOME OWNERSHIP COUNSELING NOTICE

If you obtain this "loan," which pursuant to New York State Law is a High-Cost Home Loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.

You should shop around and compare loan rates and fees. Mortgage loan rates and closing costs and fees vary based on many factors, including your particular credit and financial circumstances, your earnings history, the loan-to-value requested, and the type of property that will secure your loan. The loan rate and fees could vary based on which lender or mortgage broker you select. Higher rates and fees may be related to the individual circumstances of a particular consumer's application.

You should consider consulting a qualified independent credit counselor or other experienced financial adviser regarding the rate, fees, and provisions of this mortgage loan before you proceed. The enclosed list of counselors is provided by the New York State Banking Department.

You are not required to complete any loan agreement merely because you have received these disclosures or have signed a loan application. If you proceed with this mortgage loan, you should also remember that you may face serious financial risks if you use this loan to pay off credit card debts and other debts in connection with this transaction and then subsequently incur significant new credit card charges or other debts. If you continue to accumulate debt after this loan is closed and then experience financial difficulties, you could lose your home and any equity you have in it if you do not meet your mortgage loan obligations. *Property taxes and homeowner's insurance are your responsibility. Not all lenders provide escrow services for these payments. You should ask your lender about these services.*

Your payments on existing debts contribute to your credit ratings. You should not accept any advice to ignore your regular payments to your existing creditors. *Accordingly, it is important that you make regular payments to your existing creditors.*

Please note that this disclosure was slightly amended by SB 8143. The language above that appears in italics should be removed from the disclosure with respect to high cost home loans closed on or after July 1, 2010.

Importantly, the May 5, 2003 Amendments stated that if the Consumer Caution Notice is given to the borrower separately from the Counseling Disclosure and List of Counselors, then the

list of counselors must again be enclosed with the Consumer Caution Notice. The Consumer Caution Notice must be on a separate form. Further, in order to use an electronic transmission, the lender or broker must first obtain either written or electronically transmitted permission from the borrower.

c. Part 38 Disclosures and Monthly Payment Disclosure

The 2004 Amendments revised the timeframe under which the disclosures required by Part 38 of the General Regulations of the Banking Board (“Part 38”) must be given to the borrower in a high cost loan. Under the 2004 Amendments, these disclosures must be provided at the time of application, which must be at least ten days prior to the closing.²⁴

In addition, at or prior to taking an application, mortgage brokers and lenders must also deliver, place in the mail, fax or electronically transmit to the borrower a statement in substantially the following form, if the information is likely to be the case:

Although your aggregate monthly debt payment may decrease, the high cost home loan may increase both (i) your aggregate number of monthly debt payments and (ii) the aggregate amount paid by you over the term of the high cost home loan

This disclosure need not, however, be a separate document.

While a lender may agree with a broker that the broker will make the all the disclosures required by Part 41 and Part 38 on behalf of the lender, it remains the responsibility of the lender to ensure that such disclosures are made.

Under the 2004 Amendments, if the lender or broker does not know whether the borrower’s application is a high cost home loan application, the disclosures must be provided within three days after the lender determines that it is a high cost home loan application, but in any event, at least ten days prior to the closing.²⁵ In the event of a telephone application, the disclosures must be made within three days after receipt of the application by telephone, but in any event, at least ten days prior to the closing. In order to use electronic transmission, the lender or broker must first obtain either written or electronically transmitted permission from the borrower.

d. “Shop Around” Notice

²⁴ Previously, under the May 5, 2003 Amendments, these disclosures were required to be given at least three days prior to the closing.

²⁵ Under the May 5, 2003 Amendments, in the event that the lender or broker did not know whether the borrower’s application was a high cost home loan application, the disclosures were required to be made as soon as the lender determined that it is a high cost home loan application, but in any event, at least three days prior to the closing. In the event of a telephone application, the disclosure was required to be made immediately after receipt of the application by telephone, but in any event, at least three days prior to the closing.

In addition, the following statement in a minimum of 12-point type must appear directly above the borrower's signature line on the application:

The loan which may be offered to you is not necessarily the least expensive loan available to you and you are advised to shop around to determine comparative interest rates, points and other fees and charges.

The 2004 Amendments changed the timing in which this disclosure must be provided in telephone applications or when the lender does not know that an application is for a high cost loan. In the event of a telephone application, this disclosure must be made to the borrower within three days of receipt of an application, but in any event at least ten days prior to the closing whether or not funds are then disbursed. If the lender or broker does not know whether the borrower's application is a high cost home loan application, the disclosure must be made within three days after the lender determines that it is a high cost home loan application, but in any event, at least ten days prior to closing whether or not funds are then disbursed.²⁶

Further, the 2004 Amendments added a provision under which if the mortgage application form is prescribed by a government-sponsored entity, the statement must be placed on a separate document and attached to the front of the mortgage application.

e. High Cost Legend

High cost home loan mortgages must include a legend on top of the mortgage in 12-point type stating that the mortgage is a high cost home loan subject to Part 41 and Section 6-1 of the Banking Law.

The 2004 Amendments stated that if the mortgage document form is prescribed by a government-sponsored entity, the legend must be placed on a separate document and attached to the front of the mortgage document.

f. Disclosure of Broker Compensation

Effective September 1, 2008, SB 8143 requires any mortgage broker arranging a high cost home loan to disclose the exact amount and methodology of total compensation that the broker will receive. This disclosure must be provided to the borrower at the time of application. The Department will prescribe the form of this disclosure by regulation.

g. Disclosure of Taxes and Insurance.

²⁶ Previously, under the May 5, 2003 Amendments, in the event of telephone applications, this disclosure was required to be made to the borrower at least *three days prior* to the closing whether or not funds were then disbursed. In the event that the lender or broker did not know whether the borrower's application was a high cost home loan application, the disclosure was required to be made as soon as the lender determined that it is a high cost home loan application, but in any event, at least three days prior to closing whether or not funds were then disbursed.

SB 8143 requires that with respect to any first-lien high cost home loan, the first time a borrower is informed of the anticipated or actual periodic payment in connection with a loan for a specific property, the lender or broker must inform the borrower that an additional amount will be due for taxes and insurance and must disclose to the borrower as soon as reasonably possible the approximate amount of the initial periodic payment for property taxes and hazard insurance. This disclosure requirement applies to all high cost home loans closed on or after September 1, 2008.

5. Unfair and Deceptive Acts or Practices

Part 41 provides that the following acts constitute *prima facie* evidence that a particular lender does not possess the requisite character and fitness required to be licensed or registered by the Department:

1. **Pattern or practice of violations.** The making of high cost home loans that demonstrate a pattern and practice of violating any of Part 41's provisions. The foregoing provision applies to any lender that seeks to avoid its application by any device, subterfuge or pretense whatsoever. The May 5, 2003 Amendments clarified that this includes but is not limited to splitting or dividing any loan transaction into separate parts for the purpose of evading the provisions of Part 41 and the Statute; and
2. **Unfair, Deceptive or Unconscionable Practices.** Engaging in unfair, deceptive or unconscionable practices in the course of advertising, brokering or making high cost home loans to New York residents. Part 41 defines "unconscionable" as oppressive or unreasonably harsh or unfair, considering all of the circumstances of the loan transaction. Such practices include, but are not limited to, the following:
 - a. **Unconscionable points, fees or finance charges.** Brokering or making a high cost home loan which includes points, fees or other finance charges that, considering the loan transaction as a whole (including the creditworthiness of the borrower, the terms of the loan, the value of the collateral, and the owner's equity in the collateral), so significantly exceed the usual and customary charges incurred by mortgage consumers generally in New York for such points, fees or other finance charges as to be unconscionable;
 - b. **False or unconscionable fees.** Brokering or making high cost home loans in which the broker or lender charges and retains fees, in any manner or form:²⁷
 - i. for services that are not actually performed;

²⁷ Please note that the 2004 Amendments removed the requirement that these fees be paid by the borrower.
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- ii. for which the fees bear no reasonable relationship to the value of the services actually performed; or
 - iii. which are otherwise unconscionable;
- c. **Unconscionable repayment terms.** Brokering or making high cost home loans with repayment terms that so exceed the borrower's financial capacity to repay as to be unconscionable. A loan that complies with the provisions regarding lending without due regard to repayment ability will be presumed not to violate the foregoing. Evidence that the repayment terms exceed the borrower's reasonable capacity to repay may be rebutted by:
- i. a showing that the lender reasonably believed at the time the loan was consummated that the borrower and any obligor had the capacity to repay the loan based upon consideration of their current and expected income, current obligations, employment status, and other financial resources, excluding the owner's equity in the dwelling that secures repayment of the loan and including any other collateral securing repayment of the loan; or
 - ii. a showing that other compelling circumstances existed that justified the making of the loan notwithstanding the borrower's apparent lack of capacity to repay the loan based upon the factors stated in subparagraph (i) immediately above;
- d. **"Flipping" high cost home loans.** "Flipping" high cost home loans, which is defined as the brokering or making of a high cost home loan to a borrower that refinances an existing mortgage loan when, considering all the circumstances of the refinancing, such refinancing does not have a "tangible net benefit" to the borrower. The May 5, 2003 Amendments added this "tangible net benefit" language and stated that a high cost home loan will be presumed to have a "net tangible benefit" to the borrower if it results in the borrower receiving a monetary benefit, such as receipt of additional proceeds, a reduction of the outstanding mortgage debt, a lowering of the APR, and/or a lowering of the monthly payments of principal and interest, taking into consideration the totality of the circumstances, including, but not limited to, the loan product and the borrower's repayment ability, current and expected income and current obligations; the borrower's stated loan objectives. *Please note that the 2004 Amendments added to this list the "amount of the monetary benefit" and remove "the borrower's stated loan objectives," which had been a consideration under the May 5, 2003 Amendments. The 2004 Amendments also provided that if the monthly payment of principal and interest and/or the mortgage debt increases, a "commensurate" monetary benefit MUST ensue to the borrower;*

- e. **“Packing” high cost home loans. *The 2004 Amendments changed the definition of “packing.”*** As amended, “packing” a high cost home loan is defined as the practice of selling credit life, accident and health, disability, *property*, or unemployment insurance products, *any other life or health insurance product, debt cancellation or suspension agreement products*, or unrelated goods or services in conjunction with a high cost home loan without the informed consent of the borrower under circumstances where:
- i. the broker or lender solicits the sale of such products, goods or services; and
 - ii. the broker or lender receives direct or indirect compensation for the sale of such products, goods or services.

Please note that the definition of “packing” under the 2004 Amendments no longer only applies to charges for such products, goods, or services that are prepaid with the proceeds of the loan and financed, whether or not interest is charged, as part of the principal amount of the loan. Under the May 5, 2003 Amendments, insurance premiums were not considered financed if insurance premiums were calculated, earned and paid on a monthly or other regular, periodic basis. However, because the definition of “packing” no longer only includes insurance premiums that are financed, this provision does not appear in the 2004 Amendments.

However, it will not constitute the practice of “packing” if the broker or lender, at least *ten*²⁸ business days²⁹ before the loan is closed whether or not funds are then disbursed, makes a separate oral and a separate clear and conspicuous written disclosure in at least twelve-point type to the borrower containing the following information:

- i. the cost of such products or other goods and services;

²⁸ The May 5, 2003 Amendments had permitted this disclosure to be made three business days before closing.

²⁹ “Business day” means any calendar day except Sunday or the public holidays set forth in Section 24 of the General Construction Law, namely: the first day of January, known as New Year’s Day; the third Monday of January, known as Dr. Martin Luther King, Jr. Day; the twelfth day of February, known as Lincoln’s Birthday; the third Monday in February, known as Washington’s Birthday; the last Monday in May, known as Memorial Day; the second Sunday in June, known as Flag Day; the fourth day of July, known as Independence Day; the first Monday in September, known as Labor Day; the second Monday in October, known as Columbus Day; the eleventh day of November, known as Veterans’ Day; the fourth Thursday in November, known as Thanksgiving Day; and the twenty-fifth day of December, known as Christmas Day. If any of such days except Flag Day is Sunday, the next day thereafter is considered a public holiday. Each general election day, and each day appointed by the President of the United States or by the Governor of New York as a day of general thanksgiving, general fasting and prayer, or other general religious observance will also be considered a public holiday.

- ii. the fact that the such products, goods, or services, as offered to the borrower by the broker or lender, will be either prepaid or calculated, earned, and paid on a monthly or other regular, periodic basis;³⁰ and
- iii. that the purchase of such products, goods or services is not required to obtain the mortgage loan.

In addition, the written disclosure must contain a signed and dated acknowledgment by the borrower(s) that the oral disclosure was made and a signed and dated acknowledgment by the broker or lender that the oral disclosure was made;

- f. **Recommending or encouraging default.** Recommending or encouraging default or further default by a borrower on an existing loan or other debt, prior to and in connection with the closing or planned closing of a high cost home loan that refinances all or any portion of such existing loan or debt; and
- g. **Advertising reduction of monthly payments.** Advertising that refinancing pre-existing debt with a high cost home loan will reduce a borrower's aggregate monthly debt payment without also disclosing, if such are likely the case, that the high cost home loan will increase both:
 - i. a borrower's aggregate number of monthly debt payments; and
 - ii. the aggregate amount paid by a borrower over the term of the high cost mortgage loan.

B. Subprime Home Loan Provisions

SB 8143 enacts a number of new restrictions on "subprime home loans." Except as specifically noted below, these restrictions apply to subprime home loans closed on or after September 1, 2008. Please note as well that the definition of the term "subprime home loan" set forth in this Section only applies with respect to these requirements. SB 8143 uses identical terminology, defined differently, in other contexts.

We anticipate that the Department will update Part 41 to clarify a number of these requirements and specify which regulatory high cost home loan requirements (if any) also apply to subprime home loans. We will provide an updated memorandum when such regulations are released.

³⁰ Under the May 5, 2003 Amendments, this provision had read: "the fact that the insurance, goods, or services will be prepaid and, if applicable, financed at the interest rate provided for in the loan."

1. Definitions

a. “Home Loan”

A “home loan” is a loan incurred by a natural person primarily for personal, family or household purposes, including an open-end credit plan, but not including a reverse mortgage transaction, in which:

1. The principal amount of the loan does not exceed the conforming loan size limit for a comparable dwelling as established from time to time by Fannie Mae; and
2. The loan is secured by a mortgage or deed of trust on real estate in New York upon which there is located or there is to be located a structure or structures intended principally for occupancy by the borrower as the borrower’s principal dwelling.

b. “Subprime Home Loan”

A “subprime home loan,” in turn, is a home loan in which the fully indexed APR³¹ exceeds by more than 1.75% for a first-lien loan or by more than 3.75% for a subordinate-lien loan, the average commitment rate for loans in the Northeast Region with a comparable duration³² to the duration of the home loan, as published by Freddie Mac in its weekly Primary Mortgage Market Survey (“PMMS”)³³ as posted in the week prior to the week in which the lender receives a completed application.³⁴

³¹ As with the high cost home loan threshold, the APR should be calculated according to the provisions of TILA and Regulation Z, as amended from time to time. Please note, however, that despite this statement and consistent with the Part 41 Introductory Rate Amendments for high cost home loans, SB 8143 directs creditors to disregard introductory interest rates when calculating the APR by providing that the “fully indexed rate” for purposes of the subprime home loan APR threshold means the index rate that would have applied at the time of the closing had the initial interest rate been determined by the application of the same interest rate formula that applies under the terms of the loan documents to subsequent interest rate adjustments, disregarding any limitations on the amount by which the interest rate may change at any one time.

³² The “comparable duration” must be determined as follows: (a) for an adjustable or variable rate home loan with an initial rate that is fixed for fewer than three years, the Freddie Mac survey result for a one-year adjustable rate mortgage; (b) for an adjustable or variable rate loan with an initial rate that is fixed for at least three years, the Freddie Mac survey result for a five-year hybrid adjustable rate mortgage; (c) for a fixed rate home loan with a term of fifteen years or less, the Freddie Mac survey result for a fifteen-year fixed rate mortgage; and (d) for a fixed rate home loan with a term of more than fifteen years, the survey result for a thirty-year fixed rate mortgage. The Department may prescribe by regulation a different comparable duration standard as necessary or appropriate to reflect changes in the terms and types of mortgages included in the Freddie Mac survey.

³³ The PMMS is available at <http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp>.

³⁴ Please note that if the Department determines by statute, rule or regulation, that different thresholds for determining underwriting standards for subprime loans become applicable to nationally chartered lending institutions, or the provisions of the subprime mortgage restrictions have had an unduly negative effect of the availability or price of mortgage financing in New York, the Department may designate such other threshold rates as

Please note that the term “subprime home loan” does *not* include:

1. A home equity line of credit;
2. A transaction to finance the initial construction of a dwelling; or
3. A temporary or “bridge” loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the borrower plans to sell a current dwelling within twelve months.

c. “Lender” and “Broker”

For the purposes of the subprime home loan restrictions, the terms “lender” and “broker” are defined in the same manner as under the high cost home loan provisions.

2. Prohibited Practices for Subprime Home Loans

SB 8143 provides that subprime home loans are subject to the following limitations. Any provision in a subprime home loan that contains a prohibited term will be rendered void and unenforceable.

1. **No call provisions.** No subprime home loan may contain a provision that permits the lender, in its sole discretion, to accelerate the indebtedness. This provision does not prohibit acceleration of the loan in good faith due to the borrower’s failure to abide by the material terms of the loan.
2. **No negative amortization.** No subprime home loan may contain a payment schedule with regular periodic payments that cause or may cause the principal balance to increase. A loan will be considered to have such a schedule if the borrower is given the option to make regular periodic payments that cause the principal balance to increase, even if the borrower is also given the option to make regular periodic payments that do not cause the principal balance to increase. Please note that negative amortization may occur, however, as a result of a temporary forbearance sought by a borrower.
3. **No increased default interest rate.** A subprime home loan may not contain a provision which increases the interest rate after default. This restriction does not apply to interest rate changes in a variable rate loan otherwise consistent with the provisions of the loan documents, provided that the change in the interest rate is not triggered by the event of default or the acceleration of the indebtedness.

may be necessary to achieve parity between nationally chartered institutions and banking organizations, mortgage banks, and mortgage brokers in New York or to alleviate such unduly negative effects.

4. **Limitation on advance payments.** A subprime home loan may not include terms under which more than two periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to the borrower.
5. **No modification or deferral fees.** A lender may not charge a borrower any fees to modify, renew, extend, or amend a subprime home loan or to defer any payment due under the terms of a subprime home loan if, after the modification, renewal, extension or amendment, the loan is still a subprime home loan or, if no longer a subprime home loan, the APR has not been decreased by at least two percentage points. For the purposes of this provision, the term “fees” does not include interest that is otherwise payable and consistent with the provisions of the loan documents. A lender may charge points and fees in connection with any additional proceeds received by the borrower in connection with the modification, renewal, extension or amendment (over and above the current principal balance of the existing subprime home loan) provided that the points and fees charged on the additional sum reflect the lender’s typical point and fee structure for subprime home loans. This restriction does not apply if the existing subprime home loan is in default or is sixty or more days delinquent and the modification, renewal, extension, amendment or deferral is part of a workout process.
6. **No oppressive mandatory arbitration clauses.** No subprime home loan may be subject to a mandatory arbitration clause that is oppressive, unfair, unconscionable, or substantially in derogation of the rights of consumers.³⁵
7. **No financing of insurance or other products sold in connection with the loan.** No subprime home loan may finance, directly or indirectly, any credit life, credit disability, credit unemployment, or credit property insurance, or any other life or health insurance premiums, or any payments directly or indirectly for any debt cancellation or suspension agreement of contract, or any product or service that is not necessary or related to the home loan such as auto club memberships or credit report monitoring. Please note that a subprime home loan may finance fees paid to the lender, broker, or closing agent; fees related to the recording of the mortgage; title insurance; or other settlement fees. Insurance premiums or debt cancellation or suspension fees calculated and paid on a monthly basis will not be considered financed.
8. **No “loan flipping.”** Effective September 1, 2008, no lender or mortgage broker making or arranging a subprime home loan may engage in the unfair act or practice of “loan flipping.” The term “loan flipping” means making a home loan to a borrower that refinances an existing home loan when the new loan does not have a tangible net benefit to the borrower considering all of the circumstances, including the terms of both the new and refinanced loans, the cost of the new

³⁵ SB 8143 does not elaborate on when a mandatory arbitration clause may be found to be oppressive, unfair, unconscionable, or in derogation of consumer rights.

loan, and the borrower's situation. Please note that unlike other recent anti-predatory lending laws, SB 8143 does not specify any circumstances in which a tangible net benefit will be considered to exist.

9. **No refinancing of special mortgages.** No lender making a subprime home loan may refinance an existing home loan that is a special mortgage originated, subsidized or guaranteed by or through a state, tribal, or local government, or nonprofit organization, which either bears a below-market interest rate at the time of origination, or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income, are limited to a percentage of income, or where no payments are required under specified conditions, and where, as a result of the refinancing, the borrower will lose one or more of the benefits of the special mortgage, unless the lender is provided prior to loan closing documentation by a HUD-approved housing counselor or the lender that originally made the special mortgage that the borrower has received home loan counseling about the advantages and disadvantages of the refinancing.

10. **No lending without counseling disclosure and list of counselors.** A lender or mortgage broker must deliver, place in the mail, fax or electronically transmit the following notice in at least 12-point type to the borrower of a subprime home loan at the time of application:

You should consider financial counseling prior to executing loan documents. The enclosed list of counselors is provided by the New York State Banking Department.

In the event of a telephone application, the disclosures must be made immediately after receipt of the application by telephone. The disclosure must be on a separate form. In order to use an electronic transmission, the lender or broker must first obtain either written or electronically transmitted permission from the borrower. A list of approved counselors, available from the Department, must be provided at the same time the disclosure is given.

11. **No encouragement of default.** In making or arranging a subprime home loan, a lender or mortgage broker may not recommend or encourage default on an existing loan or other debt prior to and in connection with the closing or planned closing of the subprime home loan that refinances all or any portion of the existing loan or debt;

12. **Prohibited payments to mortgage brokers.** In making or arranging a subprime home loan, no lender or mortgage broker may accept or give any fee, kickback, thing of value, portion, split or percentage of charges, other than as payment for goods or facilities that were actually furnished or services that were actually performed. The payment must be reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

13. **No prepayment penalties.** No prepayment penalties or fees may be charged or collected on a subprime home loan. Any such penalty will be unenforceable.
14. **No abusive yield-spread premiums.** In arranging a subprime home loan, the mortgage broker must, at the time of application, disclose the exact amount and methodology for determining the total compensation that the broker will receive. This amount may be paid as direct compensation from the lender, direct compensation from the borrower, or a combination of the two. A borrower may use a yield spread premium to offset any upfront costs by accepting a higher interest rate. However, if the borrower chooses this option, any compensation from the lender that exceeds the exact amount of total compensation owed to the broker must be credited to the borrower. A broker is not precluded from accepting a lesser amount. The Department will prescribe the form of the broker compensation disclosure by regulation.
15. **Mandatory escrow of taxes and insurance.** No subprime home loan may be made after *July 1, 2010*, unless the lender requires and collects the monthly escrow of property taxes and hazard insurance. A borrower may waive escrow requirements by notifying the lender in writing after one year from consummation of the loan. *This requirement does not apply to a subordinate lien when the taxes and insurance are escrowed through another home loan. It also does not apply if the borrower can demonstrate a record of twelve months of timely payments of taxes and insurance on a previous home loan.*³⁶
16. **Mandatory disclosure of taxes and insurance payments.** With respect to a first-lien subprime home loan, the first time a borrower is informed of the anticipated or actual periodic payment amount in connection with a loan for a specific property, the lender or mortgage broker must inform the borrower that an additional amount will be due for taxes and insurance and must disclose to the borrower as soon as reasonably possible the approximate amount of the initial periodic payment for property taxes and hazard insurance.
17. **No teaser rates.** No lender or mortgage broker may make or arrange a subprime home loan which has an initial or introductory rate with a duration of fewer than six months.
18. **Subprime legend.** Subprime home loan mortgages must include a legend on top of the mortgage in 12-point type stating that the mortgage is a subprime home loan subject to Section 6-m of the Banking Law.
19. **Verification of repayment ability.** No lender or mortgage broker may make or arrange a subprime home loan unless the lender or mortgage broker reasonably

³⁶ Note that this exemption may be of limited utility, considering that unescrowed taxes and insurance are normally paid on an annual, not a monthly, basis.

and in good faith believes at the time the loan is consummated that one or more of the borrowers, when considered individually or collectively, has the ability to repay the loan according to its terms and to pay applicable real estate taxes and hazard insurance premiums. If the lender or broker knows that one or more home loans secured by the same real property will be made contemporaneously to the same borrower with the subprime home loan, the lender or mortgage broker must document the borrower's ability to repay the combined payments of all loans on the same real property.

The lender or broker's analysis of the borrower's ability to repay the subprime home loan must be based on a consideration of the borrower's credit history, current and expected income, current obligations, employment status, and other financial resources other than the borrower's equity in the real property that secures repayment of the subprime home loan. The lender or broker must take reasonable steps to verify the accuracy and completeness of information provided by or on behalf of the borrower using tax returns, payroll receipts, bank records, reasonable alternative methods, or reasonable third-party verification.

When the loan has an adjustable rate feature, the lender or mortgage broker *must* calculate the monthly payment amount for principal and interest by assuming: (a) the loan proceeds are fully disbursed on the date of the loan closing; (b) the loan is to be repaid in substantially equal monthly amortizing payments of principal and interest over the entire term of the loan, with no balloon payment, and; (c) the interest rate over the entire term of the loan is a fixed rate equal to the fully indexed rate at the time of the loan closing, without considering any initial discounted rate.

The lender or broker's repayment ability analysis may use reasonable commercially recognized underwriting standards and methodologies, including automated underwriting systems, provided that the standards and methodologies comply with the above requirements.

20. **No avoiding application of subprime provisions.** No person may in bad faith attempt to avoid the application of the subprime home loan provisions by any subterfuge, including, but not limited to, splitting or dividing any loan transaction into separate parts for the purpose of evading the subprime home loan provisions.

C. Enforcement

1. Defense to Foreclosure

Any complaint served in a foreclosure proceeding relating to a high cost home loan or a subprime home loan must contain an affirmative allegation that at the time the proceeding is commenced, the plaintiff:

1. Is the owner and holder of the subject mortgage and note, or has been delegated the authority to institute a mortgage foreclosure action by the owner and holder of the subject mortgage and note; and
2. Has complied with all of the provisions of Section 595-a of the Banking Law³⁷ and any regulations issued thereunder, the high cost home loan and/or subprime home loan restrictions described above, as applicable, and Section 1304 of the Real Property Actions and Proceedings Law.³⁸

If the terms of any high cost home loan or subprime home loan violate any of the applicable provisions described above or Section 1304 of the Real Property Actions and Proceedings Law, the compliance failure will be a defense to the action to foreclose.

2. Liability

a. High Cost Home Loans

The Statute provides that the Attorney General, the Department, or any party to a high-cost home loan may enforce the high-cost home loan provisions. Please note that the Statute provides that these remedies are not intended to be the exclusive remedies available to the borrower of a high-cost home loan. *Indeed, violations of the high-cost home loan provisions will subject the holder to rescission of the loan.*

i. Penalty Provisions

Any person found by a preponderance of the evidence to have violated the high cost home loan provisions will be liable to the borrower for the following:

1. Actual damages, including consequential and incidental damages; and
2. Statutory damages as follows:
 - a. All of the interest, earned or unearned, points and fees, and closing costs charged on the loan must be forfeited and any amounts paid must be refunded. However, the foregoing statutory damages will *not* be awarded for violations of the high-cost home loan provisions regarding: (i) “*loan flipping*”; or (ii) *lending without regard to repayment ability, so long as the lender demonstrates that at the time of the loan, it verified by detailed*

³⁷ Section 595-a of the Banking Law is a provision of the Licensing Act describing prohibited acts and practices for mortgage bankers, mortgage brokers, and exempt organizations.

³⁸ Section 1304 of the Real Property Actions and Proceedings Law contains the new foreclosure notice requirements applicable to high cost home loans, subprime home loan, and non-traditional home loans described below in Section II(A)(2) of this memorandum.

documentation all sources of the borrower's income and corroborated it with independent verification; or

- b. \$5,000 per violation or twice the amount of points and fees and closing costs, whichever is greater, for violations of the high-cost home loan provisions regarding: (i) "loan flipping"; or (ii) lending without regard to repayment ability, where the borrower is not entitled to relief under the statutory damages provisions above.

ii. Court Relief and the Right of Rescission

Significantly, the Statute provides that upon a finding by a court of an *intentional* violation by the lender of the high-cost home loan provisions, or regulations promulgated thereunder, *the home loan agreement will be rendered void, and the lender will have no right to collect, receive, or retain any principal, interest, or other charges whatsoever with respect to the loan, and the borrower may recover any payments made under the agreement.*

Further, upon a judicial finding that a high-cost home loan violates any of the high-cost home loan provisions, whether such violation is raised as an affirmative claim or as a defense, the loan transaction may be rescinded. This right of rescission may be invoked by the borrower as a defense to the holder's affirmative claim without time limitation.

The legislation also provides that a court may provide reasonable attorney fees to a prevailing borrower, as well as injunctive, declaratory and such other equitable relief as the court deems appropriate in an action to enforce compliance with the high-cost home loan provisions.

iii. Statute of Limitations

A private action against the lender or mortgage broker pursuant to the high-cost home loan provisions must be commenced within six years of origination of the high-cost home loan.

iv. Assignee Liability

The Statute provides that in any action by an assignee to enforce a loan against a borrower in default more than sixty days or in foreclosure, a borrower may assert any claims in recoupment and defenses to payment under the high-cost home loan provisions and with respect to the loan, without time limitation, that the borrower could assert against the original lender of the loan.

b. Subprime Home Loans

Any person found by a preponderance of the evidence to have violated the subprime home loan provisions will be liable to the borrower for actual damages and, in a foreclosure action, reasonable attorney fees. A borrower may also be granted injunctive, declaratory, and other equitable relief as the court deems appropriate. A violation of the subprime home loan provisions may be asserted by a borrower as a defense in any action by a lender *or assignee* to

enforce a loan against a borrower in default more than sixty days or in foreclosure. The Attorney General or the Department are also authorized to enforce the subprime home loan provisions.

Please note that, unlike the high cost home loan provisions, the subprime home loan provisions do not otherwise appear to impose any civil liability on an assignee of a subprime home loan with respect to the compliance failures of an originator. However, the equitable relief authorized by SB 8143 may conceivably encompass loan rescission or loan modification, which could impact a secondary market holder of a subprime home loan.

3. Cure Provisions

a. High Cost Home Loans

The Statute and the May 5, 2003 Amendments to Part 41 provide that a lender of a high cost home loan that, when acting in good faith, fails to comply with the high cost home loan provisions, will not be deemed to have violated Part 41 and the Statute if the lender establishes that either:

1. Within thirty days of the loan closing and prior to the institution of any action under this section, the borrower is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the borrower:
 - a. Make the high cost home loan satisfy the requirements of the high cost home loan provisions; or
 - b. Change the terms of the loan in a manner beneficial to the borrower so that the loan is no longer a high cost home loan; or
2. The compliance failure resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid such errors and, within sixty days after the discovery of the compliance failure and prior to the institution of any action under this section or the receipt of written notice of the compliance failure, the borrower is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the borrower:
 - a. Make the high cost home loan satisfy the requirements of the high cost home loan provisions; or
 - b. Change the terms of the loan in a manner beneficial to the borrower so that the loan is no longer a high cost home loan.

Examples of a bona fide error include clerical, calculation, computer malfunction and programming, and printing errors. *Please note that this is a very narrow defense and should not be relied on by creditors or their assignees.* An error of

legal judgment with respect to a person's obligations under the law is not a bona fide error.

b. Subprime Home Loans

The cure provisions with respect to subprime home loans are more limited. Under SB 8143, a lender of a subprime home loan that, when acting in good faith, fails to comply with the subprime home loan restrictions, will not be held liable if, prior to the institution of any action and before the borrower is prejudiced, the lender notifies the borrower of the compliance failure, appropriate restitution is made, and whatever adjustments that are necessary are made to the loan to make the loan satisfy the subprime home loan requirements.

4. Good Faith Reliance

A lender or assignee may not be held liable under Part 41 for any act done or omitted in good faith in conformity with any rule, regulation, release, bulletin, or interpretation thereof by:

1. The Department; or
2. With respect to provisions of Part 41 that follow the federal TILA, the Federal Reserve Board or any interpretation or approval by an official or employee of the Federal Reserve System, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

II. AMENDMENTS TO FORECLOSURE LAW UNDER SENATE BILL 8143

A. Foreclosure Restrictions for Certain Home Loans

1. Definitions

SB 8143 imposes new foreclosure restrictions on high-cost home loans, subprime home loans, and non-traditional home loans, as those terms are defined below. *Please note that, except as noted, these definitions apply only with respect to these specific requirements. SB 8143 uses identical terms, defined differently, in other contexts.* Except as explicitly noted below, these requirements will become effective with respect to foreclosure actions commenced on and after September 1, 2008.

a. Definition of "High Cost Home Loan"

The term "high cost home loan" is defined in the same manner as in Section I(A)(1)(a) of this memorandum.

b. Definition of “Home Loan”

A “home loan” is a loan, including an open-end credit plan, other than a reverse mortgage transaction, in which:

1. The principal amount of the loan at origination did not exceed the conforming loan size limit that was in existence at the time of origination for a comparable dwelling as established by Fannie Mae;
2. The borrower is a natural person;
3. The debt is incurred by the borrower primarily for personal, family, or household purposes; and
4. The loan is secured by a mortgage or deed of trust on New York real estate upon which there is located or there is to be located a structure or structures intended principally for occupancy of from one to four families which is or will be occupied by the borrower as the borrower’s principal dwelling.

c. Definition of “Subprime Home Loan”

A “subprime home loan” means a home loan consummated between January 1, 2003, and September 1, 2008, in which the terms of the loan exceed one of the following thresholds:

1. With respect to a first-lien mortgage, the APR³⁹ at consummation exceeds 3% over the yield on Treasury securities having comparable periods of maturity to the loan maturity measured as of the fifteenth day of the month in which the loan was consummated;⁴⁰ or
2. With respect to a subordinate-lien mortgage, the APR at consummation equals or exceeds 5% over the yield on Treasury securities having comparable periods of maturity to the loan maturity measured as of the fifteenth day of the month in which the loan was consummated.

³⁹ SB 8143 defines the APR in the same manner as the federal Truth-in-Lending Act, 15 U.S.C.A. § 1601 *et seq.* (“TILA”), and the regulations promulgated thereunder, as TILA and the regulations are amended from time to time. Please note, however, that if the terms of the home loan offer any initial or introductory period, and the APR is less than that which will apply after the end of such period, then the APR that must be taken into account must be the rate which applies after the initial or introductory rate. The calculation of the APR therefore appears to differ from the APR calculated according to TILA, which may reflect a blended rate in such circumstances.

⁴⁰ For the purposes of determining the threshold, the Department will publish on its website a listing of constant maturity yields for U.S. Treasury Securities for each month between January 1, 2003, and September 1, 2008, as published in the Federal Reserve Statistical Release on Selected Interest Rates, commonly referred to as the H.15 Release, in the following maturities, to the extent available in the release: six month, one year, two year, three year, five year, seven year, ten, year, and thirty year.

Please note that a “subprime home loan” does not include a transaction to finance the initial construction of a dwelling, a temporary or “bridge” loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the borrower plans to sell a current dwelling within twelve months, or a home equity line of credit.

d. Definition of “Non-Traditional Home Loan”

A “non-traditional home loan” means a payment option adjustable rate mortgage or an interest-only loan consummated between January 1, 2003, and September 1, 2008. Please note that the terms “payment option adjustable rate mortgage” and “interest-only loan” are not further defined.

e. Definition of “Lender”

The term “lender” is defined in the same manner as under the high cost home loan and subprime home loan provisions discussed in Section I of this memorandum.

2. Foreclosure Delay and Disclosure

With regard to any high cost home loan, subprime home loan, or non-traditional home loan, at least ninety days before a lender or a mortgage loan servicer commences legal action against the borrower, including mortgage foreclosure, the lender or mortgage loan servicer must give the following notice to the borrower in at least fourteen-point type:

You could lose your home. Please read the following notice carefully.

As of [date], your home is [x] days in default. Under New York State law, we are required to send you this notice to inform you that you are at risk of losing your home. You can cure this default by making the payment of [x] dollars by [date].

If you are experiencing financial difficulty, you should know that there are several options available to you that may help you keep your home. Attached to this notice is a list of government-approved housing counseling agencies in your area which provide free or very low-cost counseling. You should consider contacting one of these agencies immediately. These agencies specialize in helping homeowners who are facing financial difficulty. Housing counselors can help you assess your financial condition and work with us to explore the possibility of modifying your loan, establishing an easier payment plan for you, or even working out a period of loan forbearance. If you wish, you may also contact us directly at [number] and ask to discuss possible options.

While we cannot assure that a mutually agreeable resolution is possible, we encourage you to take immediate steps to try to achieve a resolution. The longer you wait, the fewer options you may have.

If this matter is not resolved within 90 days from the date this notice was mailed, we may commence legal action against you (or sooner if you cease to live in the dwelling as your primary residence.)

If you need further information, please call the New York State Banking Department’s toll-free helpline at 1-877-BANK-NYS (1-877-226-5697) or visit the Department’s website at <http://www.banking.state.ny.us>.

This notice must be sent by the lender or mortgage loan servicer to the borrower, by registered or certified mail and also by first-class mail to the last known address of the borrower,

and if different, to the residence which is the subject of the mortgage. Notice will be considered given as of the date the disclosure is mailed. The notice must contain a list of at least five HUD-approved housing counseling agencies, or other housing counseling agencies as designated by the Division of Housing and Community Renewal (the "Division"), that serve the region where the borrower resides. The list must include the counseling agencies' last known addresses and telephone numbers. The Department and/or the Division will make available a listing, by region, of such agencies which the lender or mortgage servicer may use to meet these requirements.

As stated in the disclosure, the lender and mortgage servicer may not commence a foreclosure action until ninety days after the disclosure is mailed. This ninety-day period will not apply, or will cease to apply, if the borrower has filed an application for the adjustment of debts of the borrower or an order for relief from the payment of debts, or if the borrower no longer occupies the residence as the borrower's principal dwelling. The notice and ninety-day period need only be provided once in a twelve-month period to the same borrower in connection with the same loan.

3. Mandatory Settlement Conference

Effective on August 5, 2008, in any residential foreclosure action involving a subprime home loan, non-traditional home loan, or high cost home loan consummated between January 1, 2003, and September 1, 2008, in which the defendant is a resident of the property subject of the foreclosure, the court must hold a mandatory conference within sixty days after the date when proof of service is filed with the county clerk, or on such adjourned date as the parties agree to, for the purpose of holding settlement discussions pertaining to the relative rights and obligations of the parties under the mortgage loan documents. The discussion must include, but need not be limited to, determining whether the parties can reach a mutually agreeable resolution to help the defendant avoid losing his or her home, and evaluating the potential for a resolution in which payment schedules or amounts may be modified or other work out options may be agreed to.

Please note that such settlement conferences are also authorized with respect to the foreclosure of any subprime home loan or high cost home loan in which the action was initiated prior to September 1, 2008, but where the final order of judgment has not yet been issued.

At any settlement conference, the plaintiff and defendant must appear in person or by counsel. If the plaintiff appears by counsel, the counsel must be fully authorized to dispose of the case. Where appropriate, the court may permit a representative of the plaintiff to attend the settlement conference telephonically or by video-conference.

If the defendant is appearing *pro se*, the court will advise the defendant of the nature of the action and his or her rights and responsibilities as a defendant. At the initial conference, any defendant appearing *pro se* will be deemed to have made a motion to proceed as a poor person under Section 1101 of the Civil Practice Rules. If the court appoints counsel to represent the defendant, it will adjourn the conference to a date certain to accommodate the appearance of counsel.

B. Initial Informational Disclosure

Effective September 1, 2008, SB 8143 amends the initial informational foreclosure notice required under preexisting law. This disclosure must be provided to the mortgagor by the foreclosing party in *any mortgage foreclosure action which involves residential real property consisting of owner-occupied one-to-four family dwellings*. The notice must be delivered with the summons and complaint to commence a foreclosure action. It must appear in bold, fourteen-point type, except for the title, which must be in bold, twenty-point type, and be printed on colored paper of a different color than the summons and complaint. As amended by SB 8143, the disclosure reads as follows:

Help for Homeowners in Foreclosure

New York State Law requires that we send you this notice about the foreclosure process. Please read it carefully.

Summons and Complaint

You are in danger of losing your home. If you fail to respond to the summons and complaint in this foreclosure action, you may lose your home. Please read the summons and complaint carefully. You should immediately contact an attorney or your local legal aid office to obtain advice on how to protect yourself.

Sources of Information and Assistance

The State encourages you to become informed about your options in foreclosure. In addition to seeking assistance from an attorney or legal aid office, there are government agencies and non-profit organizations that you may contact for information about possible options, including trying to work with your lender during this process.

To locate an entity near you, you may call the toll-free helpline maintained by the New York State Banking Department at [number] or visit the Department's website at [address].

Foreclosure Rescue Scams

Be careful of people who approach you with offers to "save" your home. There are individuals who watch for notices of foreclosure actions in order to unfairly profit from a homeowner's distress. You should be extremely careful about any such promises and any suggestions that you pay them a fee or sign over your deed. State law requires anyone offering such services for profit to enter into a contract which fully describes the services they will perform and fees they will charge, and which prohibits them from taking any money from you until they have completed all such promised services.

The Department will prescribe by regulation the telephone number and web address to be included in the disclosure. The Department will also make available the name and contact information of government agencies or non-profit organizations that may be contacted for information about the foreclosure process, including maintaining a toll-free helpline to disseminate the required information.

III. SENATE BILL 8143 AMENDMENTS TO THE LICENSING ACT

A. Mortgage Broker Duty of Good Faith and Appraisal Restrictions

1. Duty of Good Faith

Effective September 1, 2008, with respect to any transaction, including any practice or course of business in connection with the transaction, in which a mortgage broker⁴¹ solicits, processes, places or negotiates a home loan,⁴² SB 8143 requires that the mortgage broker:

1. Act in the borrower's interest;
2. Act with reasonable skill, care, and diligence;
3. Act in good faith and with fair dealing;
4. Not accept, give, or charge any undisclosed compensation, directly or indirectly, that inures to the benefit of the mortgage broker, whether or not characterized as an expenditure made for the borrower;
5. Clearly disclose to the borrower, not later than three days after receipt of the loan application, all material information as specified by the Department that might reasonably affect the rights, interests, or ability of the borrower to receive the borrower's intended benefit from the home loan, including total compensation that the broker would receive from any of the loan options that the lender or mortgage broker presents to the borrower; and
6. Diligently work to present the borrower with a range of loan products for which the borrower likely qualifies and which are appropriate to the borrower's existing circumstances, based on information known by or obtained in good faith by the broker.

⁴¹ Please refer to note 4, *supra*, for the definition of the term "mortgage broker."

⁴² Under the Licensing Act, a "home loan" or "mortgage loan" means a loan to a natural person made primarily for personal, family or household use, primarily secured by either a mortgage on residential real property or certificates of stock or other evidence of ownership interests in, and proprietary leases from, corporations or partnerships formed for the purpose of cooperative ownership of residential real property. "Residential real property," in turn, means real property located in New York improved by a one-to-four family dwelling used or occupied, or intended to be used or occupied, wholly or partly, as the home or residence of one or more persons, but does not refer to unimproved real property upon which such dwellings are to be constructed.

2. Appraisal Influence

Effective September 1, 2008, no lender or mortgage broker may improperly influence or attempt to improperly influence the development, reporting, result, or review of a real estate appraisal relating to real property securing a home loan. Notwithstanding this prohibition, a lender or broker may:

1. Ask an appraiser to consider additional information about the basis for a valuation;
2. Request that an appraiser provide additional information about the basis for a valuation;
3. Request that an appraiser correct factual errors in a valuation;
4. Obtain multiple appraisals of a borrower's principal dwelling, so long as the lender or mortgage broker adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value;
5. Withhold compensation from an appraiser for breach of contract or substandard performance of services;
6. Terminate a relationship with an appraiser for violations of applicable state or federal law or breaches of ethical or professional standards; and
7. Take action permitted or required by applicable state or federal statute, regulation, or agency guidance.

3. Enforcement

In addition to other penalties or enforcement measures that may be available under the Licensing Act, any mortgage broker or lender found by a preponderance of the evidence to have violated the duty of good faith and/or the appraisal influence restrictions, as applicable, will be liable to the borrower for actual damages. A borrower may also be granted injunctive, declaratory, and such other equitable relief as the court deems appropriate. A court may also award reasonable attorney fees to a prevailing borrower in a foreclosure action. The Attorney General or the Department may also enforce these requirements.

C. Mortgage Servicer Registration

SB 8143 requires mortgage loan servicers to register with the Department beginning on *July 1, 2009*. Specifically, the legislation provides that no person, partnership, association, corporation or other entity may engage in the business of servicing⁴³ mortgage loans with

⁴³ "Servicing mortgage loans" means receiving any scheduled periodic payments from a borrower pursuant to the terms of any mortgage loan, including amounts for escrow accounts under Section 6-K of the Banking Law, Title 3-
Thacher Proffitt & Wood LLP

respect to any property located in this state without first being registered with the Department as a mortgage loan servicer.⁴⁴ ***The registration procedure will be set forth by regulations issued by the Department, which will also establish requirements regarding:***

1. Disclosures to borrowers of the basis for any interest rate resets;
2. The provision of pay-off statements;
3. The timing of the crediting of payments;
4. Other servicing practices; and
5. Fines and penalties for non-compliance.

The Department may also require servicers to file annual reports or other regular or special reports, including reports with respect to mortgage delinquencies and foreclosures, subject to the penalty of perjury. SB 8143 also requires mortgage servicers to maintain books and records regarding servicing operations for at least three years from the date of last entry.

The following entities will be exempt from registration, but may be required to comply with requirements prescribed by the Banking Department by applicable regulation:

1. Licensed mortgage bankers and brokers; and
2. Exempt organizations.⁴⁵

Any servicer which fails to comply with the registration requirement may be required by the Department to pay a civil penalty equal to the amount authorized by Section 44 of the Banking Law.⁴⁶ If it appears that a mortgage servicer is engaged in unsafe and unsound practices, the Department may issue an order directing the discontinuance of such practices and

A of Article 9 of the Real Property Tax Law or Section 10 of 12 U.S.C.A. § 2609, and making payments to the owner of the loan or other third parties of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage service loan documents or servicing contract. In the case of a home equity conversation mortgage or reverse mortgage as referenced in Section 6-H of the Banking Law, Sections 280 and 280-A of the Real Property Law, or 24 C.F.R. § 3500.2, servicing includes making payments to the borrower.

⁴⁴ Please note that SB 8143 makes a large number of conforming changes to the Licensing Act, which generally permit the Department to regulate mortgage servicers to the same extent as mortgage bankers and brokers. This ***memorandum does not address many of these conforming changes.*** Please inform us if you would like more detailed information regarding the mortgage servicer registration requirements.

⁴⁵ The term “exempt organizations” is defined in note 3, *supra*.

⁴⁶ Section 44 of the Banking Law authorizes the Department to impose civil money penalties in amounts ranging from \$2,500 to \$75,000 per day, depending on the nature and severity of the compliance failure.

requiring the mortgage servicer to appear at a hearing to present any explanation in defense of such practices. A servicer may also be ordered to pay civil penalties in any amount established by the Department in connection with any violation of the Licensing Act or the regulations issued thereunder.

IV. RESIDENTIAL MORTGAGE FRAUD ACT

SB 8143 also enacts a new Residential Mortgage Fraud Act, which will become effective on November 1, 2008. The salient provisions of the Fraud Act are summarized below.

A. Definition of “Residential Mortgage Loan”

For purposes of the Fraud Act, a “residential mortgage loan” means a loan or agreement to extend credit, including the renewal or refinancing of any such loan, made to a person, which loan is primarily secured by either a mortgage, deed of trust, or other lien upon any interest in residential real property or certificate of stock or other evidence of ownership of residential real property.

“Residential real property,” in turn, means real property improved by a one-to-four family dwelling, or a residential unit in a building including units owned as condominiums or on a cooperative basis, used or occupied, or intended to be used or occupied, wholly or partly, as the home or residence of one or more persons. The term does not include unimproved real property upon which such dwellings are to be constructed.

B. Residential Mortgage Fraud

The Fraud Act considers residential mortgage fraud to exist whenever any person⁴⁷ knowingly and with intent to defraud presents, causes to be presented, or prepares a “fraudulent statement”⁴⁸ with knowledge or belief that the fraudulent statement will be used:

1. To solicit an applicant for a residential mortgage loan;
2. In connection with the application for, the underwriting of, or the closing of a residential mortgage loan; or
3. In documents filed with a county clerk of any county in New York arising out of and related to the closing of a residential mortgage loan.

⁴⁷ The term “person” includes any individual or entity, other than an individual who applies for a residential mortgage loan and intends to occupy the residential property securing the loan, unless that person acts as an accessory to an individual or entity committing residential mortgage fraud.

⁴⁸ For these purposes, a “fraudulent statement” is any written statement which the person knows to: (a) contain materially false information concerning any fact material thereto; or (b) conceal for the purpose of misleading, information concerning any fact material thereto.

C. Penalties

The commission of residential mortgage fraud is a Class A misdemeanor if the person receives no proceeds or other funds that in the aggregate exceed \$1,000. However, if the person receives proceeds or other funds that in the aggregate exceed that amount, the crime will be considered:

1. A Class E felony if the person receives funds or proceeds that exceed in the aggregate \$1,000;
2. A Class D felony if the funds or proceeds exceed \$3,000;
3. A Class C felony if the funds or proceeds exceed \$50,000;
4. A Class B felony if the funds or proceeds exceed \$1 million.

The Department may also refuse to grant a license or approval to operate as a mortgage banker, mortgage broker, or mortgage loan originator if it finds that the applicant, any person who is a director, officer, partner, agent, employee, substantial stockholder of the applicant, or consultant or person having a similar relationship with the applicant, has been convicted of residential mortgage fraud.

V. FORECLOSURE RESCUE ACT

SB 8143 also enacts the Rescue Act, which imposes restrictions and disclosure requirements on distressed property consultants providing services to beleaguered homeowners. The Rescue Act will become effective on September 1, 2008.

A. Definitions

1. Distressed Home Loan

A “distressed home loan” means a home loan⁴⁹ that is in danger of being foreclosed because the homeowner⁵⁰ has one or more defaults under the mortgage that entitle the lender to

⁴⁹ A “home loan” is a loan in which the debt is incurred by the homeowner primarily for personal, family or household purposes, and the loan is secured by a mortgage or deed of trust on property upon which there is located or there is to be located a structure or structures intended principally for occupancy by from one to four families which is or will be occupied by the homeowner as the homeowner’s principal dwelling. “Property” means real property located in New York improved by a one-to-four family dwelling used or occupied, or intended to be used or occupied, wholly or partly, as the home or residence of one or more persons, but does not include unimproved real property upon which such dwellings are to be constructed.

⁵⁰ A “homeowner” is a natural person who is the mortgagor with respect to a distressed home loan or who is in danger of losing a home for non-payment of taxes.

accelerate full payment of the mortgage and repossess the property, or a home loan where the lender has commenced a foreclosure action.

2. Consulting Services

“Consulting services” means services provided by a distressed property consultant, as defined below, to a homeowner that the consultant represents will help to achieve any of the following:

1. Stop, enjoin, delay, void, set aside, annul, stay or postpone a foreclosure filing, a foreclosure sale or the loss of a home for non-payment of taxes;
2. Obtain forbearance from any servicer, beneficiary, or mortgagee or relief with respect to the potential loss of the home for non-payment of taxes;
3. Assist the homeowner to exercise a right of reinstatement or similar right provided in the mortgage documents or any law or to refinance a distressed home loan;
4. Obtain any extension of the period within which the homeowner may reinstate or otherwise restore his or her rights with respect to the property;
5. Obtain a waiver of an acceleration clause contained in any promissory note or contract secured by a mortgage on a property in foreclosure;
6. Assist the homeowner in answering or responding to a summons and complaint, or otherwise providing information regarding the foreclosure complaint and process;
7. Avoid or ameliorate the impairment of the homeowner’s credit resulting from the commencement of a foreclosure proceeding or tax sale;
8. Assist the homeowner to obtain a loan or advance of funds; or
9. Save the homeowner’s property from foreclosure or loss for non-payment of taxes.

3. Distressed Property Consultant

A “distressed property consultant” is an individual or a corporation, partnership, limited liability company, or other business entity that directly or indirectly solicits or undertakes employment to provide consulting services to a homeowner for compensation or promise of compensation with respect to a distressed home loan or a potential loss of the home for nonpayment of taxes.

A consultant does not include:

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1. An attorney admitted to practice in the State of New York;
2. *A person or entity who holds or is owed an obligation secured by a lien on any property in foreclosure while the person or entity performs services in connection with the obligation or lien;*
3. A bank, trust company, private banker, bank holding company, savings bank, savings and loan association, thrift holding company, credit union or insurance company organized under the laws of New York, another state, or the United States, or a subsidiary or affiliate of such an entity or a foreign banking corporation licensed by the Department or the Comptroller of the Currency;
4. A mortgagee approved by HUD and any subsidiary or affiliate of such a mortgagee, and any agent or employee of such persons while engaged in the business of the mortgagee;
5. A judgment creditor of the homeowner, if the judgment creditor's claim accrued before the written notice of foreclosure sale is sent;
6. A title insurer authorized to do business in New York, while performing title insurance and settlement services;
7. A person licensed as a mortgage banker, mortgage broker, or mortgage loan servicer as defined in the Licensing Act;
8. A bona fide not-for-profit organization that offers counseling or advice to homeowners in foreclosure or loan default; or
9. A person licensed or registered in New York to engage in the practice of other professions that the Department has determined should not be subject to the Rescue Act.

B. Homeowner's Right to Cancel

A homeowner has the right to cancel, without any penalty or obligation, any contract with a distressed property consultant until midnight of the fifth business day following the day on which the distressed property consultant and the homeowner sign a consulting contract. Cancellation occurs when the homeowner or a representative of the homeowner either delivers written notice of cancellation in person to the address specified in the consulting contract or sends a written communication by facsimile, by United States mail, or by an established commercial letter delivery service. A dated proof of facsimile delivery or proof of mailing creates a presumption that the notice of cancellation has been delivered on the date the facsimile is sent or the notice is deposited in the mail or with the delivery service. Cancellation of the contract will release the homeowner of all obligations to pay fees or any other compensation to the consultant.

The consulting contract must be accompanied by two copies of a form captioned "Notice of Cancellation" in at least 12-point bold type. This form must be attached to the contract, be easily detachable, and contain the following statement written in the same language used in the contract:

Notice of Cancellation

Note: You may cancel this contract, without any penalty or obligation, at any time before midnight of [date].

To cancel this contract, sign and date both copies of this cancellation notice and personally deliver one copy or send it by facsimile, United States mail, or an established commercial letter delivery service, indicating cancellation to the distressed property consultant at one of the following:

Name of Contractor:

Street Address:

City, State, ZIP:

Facsimile:

I hereby cancel this transaction.

Name of Homeowner:

Signature of Homeowner:

Date:

Within ten days following receipt of a notice of cancellation given in accordance with these requirements, the consultant must return any original contract and any other documents signed by or provided by the homeowner. Cancellation will release the homeowner of all obligations to pay any fees or compensation to the consultant.

C. Distressed Property Consultant Prohibitions

SB 8143 provides that a distressed property consultant may not:

1. Perform any consulting services without a written, fully executed consulting contract with a homeowner;
2. Charge or accept payment for consulting services before the fully completion of such services;
3. Take a power of attorney from a homeowner;
4. Retain any original loan document or other original document related to the distressed home loan, the property or the potential loss of the home for nonpayment of taxes; or
5. Induce or attempt to induce a homeowner to enter into a consulting contract that does not fully comply with the provisions of the Rescue Act.

D. Distressed Property Consulting Contract Requirements

A distressed property consulting contract must:

1. Contain the entire agreement of the parties;
2. Be provided in writing to the homeowner for review before signing;
3. Be printed in at least 12-point type and written in the same language that is used by the homeowner and was used in discussions between the consultant and the homeowner to describe the consultant's services or to negotiate the contract;
4. Fully disclose the exact nature of the distressed property consulting services to be provided by the consultant or anyone working in association with the consultant;
5. Fully disclose the total amount and terms of compensation for the consulting services;
6. Contain the name, business address, and telephone number of the consultant and the street address (if different) and facsimile number or email address of the consultant where communications from the homeowner may be delivered; and
7. Be dated and personally signed by the homeowner and the consultant and be witnessed and acknowledged by a New York notary public.

The consulting contract must also contain the following notice, which must be printed in at least 14-point, boldface type, completed with the name of the consultant, and located in immediate proximity to the space reserved for the homeowner's signature:

Notice Required by New York Law

You may cancel this contract, without any penalty or obligation, at any time before midnight of [fifth business day after execution].

[Name of consultant] (the "Consultant") or anyone working for the Consultant may not take any money from you or ask you for money until the consultant has completely finished doing everything this contract says the consultant will do.

You should consider consulting an attorney or a government-approved housing counselor before signing any legal document concerning your home. It is advisable that you find your own attorney, and not consult with an attorney recommended or provided to you by the consultant. A list of housing counselors may be found on the website of the New York State Banking Department, www.banking.state.ny.us or by calling the Banking Department toll-free at 1-877-BANK-NYS (1-877-226-5697). The law requires that this contract contain the entire agreement between you and the consultant. You should not rely upon any other written or oral agreement or promise.

E. Penalties

If a court finds that a distressed property consultant has violated any of these provisions, the court may make null and void any agreement between the homeowner and consultant. If the

homeowner suffers damage because of the violation, the homeowner may recover actual and consequential damages and costs. The court may also award treble damages, attorney fees, and costs, if the violation was reckless or intentional.

In addition to these remedies, whenever a consultant violates the Rescue Act, the Attorney General may apply to a court of justice having jurisdiction by a special proceeding to issue an injunction, and upon notice to the defendant of not less than five days, to enjoin and restrain the continuance of such violations, without proof that any person has been injured or damaged by the violation. The court may award the Attorney General the costs of bringing the action and also order restitution. The court may also impose a civil penalty of not more than \$10,000 for each violation.

Any provision of a consulting contract that attempts or purports to limit the liability of the consultant under the Rescue Act will be null and void. The inclusion of any such provision will at the option of the homeowner render the consulting contract void. Any provision in a contract which attempts or purports to require arbitration of any dispute arising under the Rescue Act will be void at the option of the homeowner. Any waiver of the provisions of the Rescue Act will be void and unenforceable as contrary to public policy.

Please call Stephen F.J. Ornstein, Matthew S. Yoon, David A. Tallman, or John P. Holahan at (202) 347-8400 with any questions.