

NEXT DOOR, BUT WORLDS APART: COMPARING PENNSYLVANIA AND NEW JERSEY'S ANTI-PREDATORY LENDING LEGISLATION

Leonard A. Bernstein*

I. INTRODUCTION

Within three years of one another, Pennsylvania and New Jersey joined approximately twenty-two other states by enacting anti-predatory lending legislation aimed at preventing abusive lending practices within their respective subprime mortgage markets.¹ Referring to a wide array of deceptive lending practices that disproportionately affect lower-income families, elderly and minority homeowners, the issue of predatory lending has engendered very different legislative responses at both the state and national levels.² Some states have affirmatively maintained that legislation “affecting the subprime market should not be overly broad and should restrict only those relatively few lenders who are purposefully engaged in patterns of unfair

* **Leonard A. Bernstein** chairs the multi-office Financial Services Regulatory Group of Reed Smith LLP. The Financial Services Regulatory Group counsels lenders on compliance with state and federal law, and defends lenders in class action and other consumer litigation. Len is the past Chair of the Philadelphia Bar Association's Business Law Section and Young Lawyers Division, and the past Chair of the New Jersey State Bar Association's Banking Law Section. Len splits his time between the firm's Philadelphia, Pennsylvania and Princeton, New Jersey offices. Len was elected to the American College of Consumer Financial Services Attorneys. Len can be reached at 215-851-8143/609-520-6005 or lbernstein@reedsmith.com.

¹ Background Paper: The “New Jersey Home Ownership Security Act of 2002”- Protections for Consumers from Abusive or Predatory Lending Practices, N.J. Dept. of Banking and Ins., 13 (May 6, 2003) *available at* http://www.mbaa.org/state_update/2003/nj/Banking%20Dept%20Analysis_A75.pdf.

² Tania Davenport, *An American Nightmare: Predatory Lending in the Subprime Home Mortgage Industry*, 36 SUFFOLK U. L. REV. 531, 545-54 (2002). This article discusses the broad range of federal statutes enacted to combat abusive lending practices, including (1) the Truth in Lending Act (TILA), TILA Reg. Z, 12 C.F.R. § 226 (2002); (2) the Home Ownership Equity Protection Act (HOEPA), 12 C.F.R. § 226.32 (1994); (3) the Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691 (2002); and (4) the Federal Trade Commission Act (FTC act), 15 U.S.C. §45(a)(1) (2002).

treatment to vulnerable consumers.”³ Other states, however, have enacted relatively severe, all-encompassing laws whereby aggrieved borrowers may sue all parties to the transaction, from the lender to the trust that issues the securitized loans, and may even exact punitive damages from third-party investors in the securities backed by the loans.⁴ Ironically, the Office of the Comptroller of the Currency (OCC) has stated that there exists substantial empirical evidence that certain “anti-predatory statutes can impede the flow of mortgage credit, especially to low income and higher-risk borrowers, and that any reduction in predatory abuses resulting from these measures is probably achieved at the expense of many legitimate loans.”⁵ In many states, as well as within the federal government, the challenge has been to establish a balance between the need to make home loans available to credit-impaired borrowers, and the need to protect those borrowers from credit that is unjustifiably expensive, inappropriate, or tainted by fraud or deceit.⁶ Accordingly, the central purpose of this article is to distinguish between these two different approaches to the problem of predatory lending, as exemplified by the recent legislative enactments of Pennsylvania and neighboring New Jersey.⁷

³ 63 PA. STAT. ANN. § 456.502(3) (West 2001) (quoting the “Legislative findings” section of Pennsylvania’s “Mortgage Bankers and Brokers and Consumer Equity Protection Act,” hereinafter the Pennsylvania Act).

⁴ Agnes T. Crane, *S&P Shuns Georgia Mortgages Due to Predatory Lending Law*, DOW JONES INT’L NEWS, Jan. 13, 2003.

⁵ OCC Working Paper: Economic Issues in Predatory Lending, 2, Comptroller of the Currency, Washington, DC (Jul. 30, 2003), available at <http://www.mbaa.org/resources/predlend/>.

⁶ Davenport, *supra* note 2, at 534.

⁷ Revisions and expansions to the Pennsylvania Act, particularly Chapter 5 on predatory lending, were enacted on July 25, 2001, and became effective July 25, 2003. 63 PA. STAT. ANN. § 456. “The New Jersey Home Ownership Security Act of 2002 (hereinafter New Jersey Act) was signed into law on May 1, 2003 as Bill No. A-75, and becomes effective on November 27, 2003. (N.J. STAT. ANN § 46:10B *et seq*) (West 2003).

II. THE PRINCIPAL DIFFERENCES BETWEEN PENNSYLVANIA AND NEW JERSEY'S ANTI-PREDATORY LENDING LAWS

Pennsylvania's anti-predatory lending legislation represents a realistic effort to combat abusive lending practices, because the relative specificity of the law adequately protects citizens of the Commonwealth while at the same time allowing lenders and secondary-market participants to assess the risks involved with subprime loans, and securities backed by those loans, through the exercise of reasonable due diligence.⁸ New Jersey's pending law, however, appears unduly onerous because of the lack of clarity about which loans are covered under the law, as well as a lack of limits on penalties and assignee liability.⁹ In fact, both Fitch Ratings and Standard & Poor's have stated that they will no longer rate certain residential mortgage-backed securities (RMBS) transactions which contain loans originated in New Jersey after November 26, 2003.¹⁰ While the issue may be rendered moot to a considerable degree should the Office of Thrift Supervision (OTS) or the OCC move to preempt either state's anti-predatory lending laws,¹¹ the concern remains that state overregulation of the mortgage industry will

⁸ A number of companies such as LogicEase Solutions, Inc. provide computerized testing against HOEPA "interest-rate" and "points-and-fees" triggers to ensure compliance with state and national lending laws. *See website at* http://www.complianceease.com/prod/prod_pa_overview.jsp.

⁹ *S&P Surprises Lenders: Decision Not to Rate Certain Pools Cuts New Predatory Law Support*, BROKER MAGAZINE, Jun. 6, 2003, available at 2003 WL 13145248.

¹⁰ *Fitch Ratings Responds to New Jersey Predatory Lending Legislation*, FITCH RATINGS, Jun. 5, 2003, available at http://www.mbaa.org/industry/reports/03/fitch_0605.pdf. *See also S&P Report Addresses New Jersey State Predatory Lending Law*, STANDARD & POOR'S, May 2, 2003. While Fitch Ratings has stated that it will rate some residential mortgage-backed securities (RMBS) containing certain home loans originated in New Jersey, provided that Fitch receives a certificate of due diligence from an unaffiliated third-party affirming that the loan pool does not contain any "high-cost" or "covered" home loans, Standard & Poor's maintains that they will not rate RMBS transactions containing any home loans originated in New Jersey.

¹¹ *Preemption of New Jersey Predatory Lending Act*, OTS Op. Chief Counsel, P-2003-5 (Jul. 22, 2003). On July 22, 2003, the Office of Thrift Supervision concluded that the provisions of the New Jersey Act which "purport to regulate the terms of credit, loan-related fees, disclosures, mortgage processing, origination, refinancing and servicing, and disbursements are preempted by federal law from applying to federal savings associations" and their operating subsidiaries.

ultimately hurt consumers.¹² Therefore, it is important to distinguish between the prevailing theories of how to best prevent abusive and deceitful mortgage lending practices as embodied in Pennsylvania and New Jersey's current anti-predatory lending laws.

A. Background

There is no single, generally accepted definition of a predatory loan. A term loosely employed by community groups, policymakers and regulators to refer to a wide range of abusive or deceptive lending practices in a variety of areas, including home mortgages, auto loans, credit cards, and payday loans, predatory lending is difficult to pin down because a loan considered abusive in one set of circumstances does not smack of unfairness in another.¹³ The federal Home Ownership and Equity Protection Act (HOEPA) of 1994 has served as the basis for many of the definitions of predatory lending within the context of a home loan.¹⁴ It classifies mortgage loans with relatively high interest rates and fees as potentially predatory, and imposes upon them a range of consumer protections.¹⁵ Conduct also associated with predatory lending includes orally contradicting written disclosures within the loan document, balloon payments, loan flipping, unnecessary credit insurance, and making loans the lender knows cannot reasonably be paid back.¹⁶

However, not all of these practices necessarily equate to predatory lending on their face. Predatory lending can only occur where a customer is actually taken advantage of by a lender or

¹² *New Jersey Learns Lesson From Georgia*, 27 NAT'L MORTGAGE NEWS, Mar. 31, 2003, available at 2003 WL 7685136.

¹³ OCC Working Paper: Economic Issues in Predatory Lending, *supra* note 5, at 6.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Resources which explain in detail the wide range of abusive and predatory lending practices include (1) ELIZABETH RENUART, NATIONAL CONSUMER LAW CENTER, STOP PREDATORY LENDING (2002); (2) the Predatory Lending Resource Center website, available at <http://www.mbaa.org/resources/predlend/>; and (3) the Responsible Lending.org: A Resource for Predatory Lending Opponents, available at <http://www.responsiblelending.org/index.cfm>.

mortgage broker, because a loan transaction which takes advantage of one consumer may actually be beneficial to another, depending upon that consumer's current situation and, more importantly, that consumer's knowledge of his or her options.¹⁷ This distinction is fundamental to a comprehensive understanding of the differences between Pennsylvania and New Jersey's anti-predatory lending laws, because while the Pennsylvania Act requires that a "lender purposefully engage in a pattern or practice of material violations" to be subject to civil liability, the New Jersey Act imposes strict liability without reference to the circumstances or context in which the loan was made. Therefore, this section will compare and contrast both state's (1) interest-rate thresholds and points-and-fees triggers, (2) penalties, (3) safe-harbor provisions and (4) potential for assignee liability, according to the specific language of Pennsylvania and New Jersey's respective anti-predatory lending statutes.

B. Interest-rate thresholds and points-and-fees triggers

One of the major differences between Pennsylvania and New Jersey's anti-predatory lending laws revolves around their "interest-rate" and total "points-and-fees" triggers.¹⁸ These thresholds determine as a preliminary matter whether each state's anti-predatory lending laws pertain to a particular home loan, as well as establish the penalties and remedies which may be applicable if either the interest-rate threshold or points-and-fees triggers are exceeded. A New Jersey home loan is either a "high-cost home loan" or a "covered home loan" if the terms of the loan exceed either a specific interest-rate or total points-and-fees threshold.¹⁹ This categorization is significant because only "high-cost home loans" and

¹⁷ OCC Working Paper: Economic Issues in Predatory Lending, *supra* note 5, at 6.

¹⁸ Under the Pennsylvania Act, the "interest-rate" and "total points-and-fees" thresholds are defined at 63 P.S. § 456.503. Under the New Jersey Act, the "interest-rate" and "total points-and-fees" thresholds are defined at § 46:10B-24.

¹⁹ The New Jersey Act defines these terms at § 46:10B-24, classifying the three categories of home loans as follows: a "high-cost home loan" is a home loan for which the principal amount of the loan does not exceed \$350,000 (adjusted annually), and for which the points and fees exceed a specified threshold; a "covered home loan" is a home loan for which the points and fees exceed

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“covered home loans” are subject to the more draconian penalty provisions of the New Jersey Act.²⁰

The interest-rate threshold under the New Jersey Act is tied to the annual percentage rate (APR) threshold under HOEPA, currently eight percentage points above comparable Treasury yields for first-lien loans, and ten percentage points above comparable Treasury yields for subordinate-lien loans.²¹ Alternatively, the total “points-and-fees” threshold under the New Jersey Act is triggered when the points and fees charged in conjunction with a home loan exceed (a) five percent of the total loan amount for loans equal to or more than \$40,000; (b) six percent of the total loan amount for loans equal to or more than \$20,000, but less than \$40,000; or (c) the lesser of six percent of the total loan amount, or \$1,000 for other loans.²² It should be emphasized that the interest-rate and total points-and-fees thresholds under the New Jersey Act are not caps, but rather determine whether other provisions of New Jersey’s predatory lending law apply to a particular loan.²³

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a specified threshold; and a “home loan” is an extension of credit primarily for personal, family or household purposes, including an open or closed-end credit plan, other than a reverse mortgage transaction, in which the loan is secured by (1) a mortgage of deed of trust on New Jersey real estate with a one- to six-family dwelling that the borrower will occupy as his principal dwelling, or (2) a security interest in a manufactured home that the borrower will occupy as his principal dwelling. A “high-cost” home loan is automatically considered a “covered” loan for purposes of the Act.

²⁰ N.J. STAT. ANN § 46:10B-28. *See infra* Part II.C.

²¹ *Id.* § 46:10B-24. Up-to-date treasury yields may be found at the Federal Reserve Board’s “Selected Interest Rates” daily release, *available at* <http://www.federalreserve.gov/release/h15/update/>.

²² *Id.* The definition of “Points and Fees” under the New Jersey Act excludes a “conventional prepayment penalty,” or up to two “bona fide discount points.”

²³ E. ROBERT LEVY, PENNSYLVANIA’S NEW CONSUMER EQUITY PROTECTION LAW AMENDING THE MORTGAGE BANKERS AND BROKERS ACT AND OTHER AMENDMENTS PURSUANT TO SENATE BILL NO. 377, *available at* http://www.mbaa.org/state_update/2002/pa/sb377_0110.pdf. Like the Pennsylvania Act and HOEPA, the New Jersey Act does not put a ceiling on interest-rates or

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In Pennsylvania, as in New Jersey, no home loan is subject to any provision of the Commonwealth's anti-predatory lending law unless it also meets specific "interest-rate" and total "points-and-fees" triggers.²⁴ Under the Pennsylvania Act, both the interest-rate and total points-and-fees-thresholds for covered loans are aligned explicitly with that for loans governed by HOEPA.²⁵ As the interest-rate thresholds are identical under both the Pennsylvania and New Jersey Acts, the actual difference between the two statutes, in addition to the obvious difference between the method of calculating total points-and-fees, lies in the details and definitions of exactly what constitutes those points-and-fees. First, the New Jersey Act has a lower total points-and-fees ceiling than that under either HOEPA or the Pennsylvania Act, based upon the formula used to calculate that threshold dollar amount.²⁶ Simply stated, the total points-and-fees ceiling under the New Jersey Act is two to three percentage points lower than the comparable threshold under HOEPA, meaning that a New Jersey home loan is more likely at the outset to be deemed potentially predatory than a comparable loan originated in Pennsylvania.²⁷

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total points-and-fees, but rather uses these as thresholds which trigger other provisions of the law.

²⁴ 63 PA. STAT. ANN. § 456.511.

²⁵ A "Covered Loan" in Pennsylvania is one for which the original principal balance of the loan is less than \$100,000. A "covered loan" is further defined as a consumer credit mortgage loan transaction involving property located within the Commonwealth of Pennsylvania "that is considered a mortgage under section 103(aa) of the Truth in Lending Act (Public Law 90-321 15 U.S.C. § 1602(aa)) and regulations adopted pursuant thereto by the Federal Reserve Board, including 12 C.F.R. § 226.32 (relating to requirements for certain closed-end home mortgages)." See 63 P.S. § 456.503.

²⁶ Compare an eight-percent ceiling under the Pennsylvania Act with a five to six-percent ceiling under the New Jersey Act.

²⁷ A loan is "covered" under HOEPA and the Pennsylvania Act if the total point-and-fees paid by the loan consumer exceeds the greater of eight-percent of the total loan amount, or an annually adjusted amount currently set at \$480 on October 1, 2002. This eight-percent ceiling is compared with the five to six-percent ceiling under the New Jersey Act to arrive at a difference of two to three-percent.

Second, the definition of total “points and fees” is of critical importance in determining whether a loan will be considered a “covered loan” under either the Pennsylvania or New Jersey Acts. The Pennsylvania law does not provide a separate definition for points-and-fees, but again makes use of the general definition of a “covered loan” under 15 U.S.C. § 1602, thereby incorporating the criteria for determining total points-and-fees under HOEPA into the Pennsylvania Act.²⁸ New Jersey, on the other hand, furnishes its own complex definition of points-and-fees, enumerating seven categories of items and charges which may be included in this calculation, as well as an equally long list of items and charges which are specifically excluded from the definition of points-and-fees.²⁹ The core of the difference between the two laws in this context is that the New Jersey law combines the specific language of HOEPA and Regulation Z with its own terminology.³⁰ As such, the lack of clarity in the definition of points-and-fees, which directly effects the mathematical calculation as to whether a loan is a “covered loan” under the New Jersey Act, is one of the reasons both Standard & Poor's and Fitch Ratings

²⁸ “Points and fees” are defined under HOEPA and Reg. Z § 226 as: (1) all finance charges required to be disclosed under 12 C.F.R. §§ 226.4(a) and (b), except the interest or time-price differential; (2) all brokers fees; (3) closing costs listed in 12 C.F.R. § 226(c)(7) if the lender or some entity affiliated with the lender receives some part thereof; (4) all direct and indirect compensation to a mortgage broker including that of a table funded originator (unless already included); (5) the premium for any single-premium credit life, credit disability, credit unemployment or any other life or health insurance financed by the loan; (6) any fees for preparing loan documents; (7) minus any fees excluded by paragraphs (c) through (e) of Reg. Z of the Truth in Lending Act, § 226.4 of Title 12 of the Code of Federal Regulations.

²⁹ N.J. STAT. ANN § 46:10B-23.

³⁰ In fact, the New Jersey Department of Banking and Insurance issued a clarification on July 29, 2003, stating that there may be confusion “because the definition of ‘points and fees’ includes ‘all items’ listed in 15 U.S.C. 1605(a)(1) through (4), with specified exceptions, and includes ‘all charges listed in 15 U.S.C. 1605(e).’” The Department of Banking and Insurance further stated that it “is noteworthy that the Act’s reference to 15 U.S.C. 1605(e) in the definition of ‘points and fees’ references ‘charges’ rather than ‘items.’ Escrows for taxes and insurance are not ‘charges’ and thus are not included in this portion of the Act’s definition of ‘points and fees.’ It should be noted that actual escrow charges (i.e. when a lender charges a fee for maintaining an escrow) and other specified items are only excluded from the definition of ‘points and fees’ as long as the conditions of the exclusion are met.” N.J. Dept. of Banking and Ins., Bulletin No. 03-15, 7, Jul. 29, 2003, available at http://www.mbaa.org/state_update/2003/nj/bulletin03-15.pdf.

have concluded that they will not allow certain New Jersey loans originated after November 26, 2003 to be included in their rated structured finance transactions.³¹

C. Penalties

The second major distinction between the Pennsylvania and New Jersey Acts revolves around the penalties which may be imposed upon mortgage lenders whose loans violate their respective state's anti-predatory lending laws. Under the Pennsylvania law, the Department of Banking is given extensive examination, investigatory and subpoena powers pursuant to Section 456.521 of the Pennsylvania Act.³² If the Department of Banking determines that any provision of the Pennsylvania Act was violated, it is authorized use its discretion in levying a variety of administrative penalties.³³ First, it may impose a fine of up to \$2,000 per violation, plus investigative costs.³⁴ Second, it may suspend, revoke or refuse to renew any license issued by the Department of Banking.³⁵ Third, it may prohibit or remove any individual from the lending or brokerage business within the Commonwealth of Pennsylvania.³⁶ Fourth, it may issue a cease-and-desist order, and require restitution be paid for actual damages to borrowers.³⁷ Fifth, the Department of Banking may impose such other conditions as it deems appropriate.³⁸

³¹ *S&P Surprises Lenders, supra* note 8. *See also S&P Report Addresses New Jersey State Predatory Lending Law*, STANDARD & POOR'S, May 2, 2003.

³² Jonathan L. Levin, *Complying with the New Pennsylvania Subprime Lending Law*, 56 CONSUMER FIN. L.Q. REP. 107, 109 (2002).

³³ 63 PA. STAT. ANN. § 456.521(d). A licensee can appeal any of the administrative penalties imposed under Section 456.521(d) by the Department of Banking to the Secretary of Banking. Judicial review of the decision by the Secretary of Banking is also available under the Act. *See also* § 456.521(g) and (h).

³⁴ *Id.* § 456.521(d)(1).

³⁵ *Id.* § 456.521(d)(2).

³⁶ *Id.* § 456.521(d)(3).

³⁷ *Id.* § 456.521(d)(4).

³⁸ *Id.* § 456.521(d)(5).

Furthermore, the Department of Banking may also “seek a court injunction to restrain a person from engaging in predatory lending practices, and it may share enforcement-related information with other appropriate federal or state regulatory agencies.”³⁹

In addition to the administrative penalties which may be imposed by the Department of Banking under the Pennsylvania Act, mortgage lenders may also be civilly liable to borrowers for damages stemming from “material violations” of Pennsylvania’s anti-predatory lending law.⁴⁰ A mortgage lender will only be liable, however, if it “purposefully engages in a pattern or practice of material violations” of the Pennsylvania Act.⁴¹ Therefore, notwithstanding Commonwealth licensing repercussions, the maximum, quantifiable penalty for each violation of Pennsylvania’s anti-predatory lending law is \$2000, plus actual damages incurred by the consumer.⁴²

New Jersey’s multifaceted compliance scheme, by comparison, contains a number of overlapping penalties which may potentially exceed the principal amount of the loan.⁴³ First, a violation of the New Jersey Act necessarily constitutes an unlawful practice under the New Jersey Consumer Fraud Act, which permits legal and equitable relief, treble damages, as well as costs and attorney’s fees.⁴⁴ Second, as an alternative to remedies under the New Jersey Consumer Fraud Act, borrowers may recover statutory damages, i.e. regardless of actual

³⁹ Levin, *supra* note 30, at 109.

⁴⁰ 63 PA. STAT. ANN. § 456.522(a).

⁴¹ *Id.* § 456.522(d).

⁴² Mandatory compliance affects only those “covered” loans originated on or after June 25, 2002. *See* Levin *supra* note 30, at 109.

⁴³ OCC Working Paper: Economic Issues in Predatory Lending, *supra* note 5, at 2.

⁴⁴ N.J. STAT. ANN. § 46:10B-29(8)(a). *See also* N.J. STAT. ANN. § 56:8-1 *et seq.* (the “New Jersey Consumer Fraud Act”).

damages, for material violations “equal to the finance charge agreed to in the home loan agreement, plus up to 10% of the amount financed.”⁴⁵ Third, for violations deemed “malicious or reckless,” unspecified punitive damages may likewise be assessed.⁴⁶ Fourth, the New Jersey Department of Banking and Insurance may also levy an additional civil penalty of up to \$10,000 for each offense.⁴⁷ When compared with the maximum penalties assessable under Pennsylvania law, the penalties under the New Jersey Act appear draconian.⁴⁸ For each loan originated in New Jersey, the potential damages enumerated under the statute may well exceed the principal amount of the loan.⁴⁹ Furthermore, there does not seem to be any way to quantify the punitive damages under the New Jersey Act, as no guidance nor limitations on these damages is specified. Therefore, as the potential liability stemming from home loans originated in New Jersey so greatly outweighs prospective profits, many subprime lenders and rating agencies have stated that they intend to pull out of the New Jersey market before the Act becomes effective on November 27, 2003.⁵⁰

D. Safe Harbor Provisions

⁴⁵ N.J. STAT. ANN. § 46:10B-29(8)(b)(1)(a).

⁴⁶ *Id.* § 46:10B-29(8)(b)(1)(b).

⁴⁷ *Id.* § 46:10B-28(7)(d)(1). Under this section of the New Jersey Act, the Department of Banking and Insurance also has the broad authority to suspend and revoke any licenses issued by that Department.

⁴⁸ For a hypothetical \$100,000, twenty-year “covered” loan, with \$8,000 in interest payable each year, the maximum statutory penalty would be the \$160,000 finance charge (\$8,000 x 20 = \$160,000), plus ten-percent of the total amount financed (\$100,000 x 10% = \$10,000), plus a \$10,000 civil penalty, for a total penalty of \$180,000 (plus unspecified punitive damages), regardless of whether the borrower suffered any actual damages as a result of the loan. This is compared with a \$2,000 penalty, plus actual damages, under the Pennsylvania Act.

⁴⁹ Crane, *supra* note 4.

⁵⁰ *S&P Surprises Lenders*, *supra* note 9.

The third major difference between Pennsylvania and New Jersey’s anti-predatory lending statutes centers around their safe harbor provisions. There is no specific safe harbor provision to the Pennsylvania Act, but there is an implied safe harbor in that lenders will only be exposed to civil liability where they “purposefully engage in a pattern or practice of material violations.”⁵¹ While lenders may not circumvent the administrative penalties under Section 456.521(d) for violations of the Pennsylvania Act under any circumstances, lenders will not be subject to civil liability unless they are found to have willfully and persistently preyed upon consumers.⁵² This enables Pennsylvania mortgage lenders to quantify their maximum liability under the Act, presuming that they are not actually engaging in a pattern or practice of predatory lending, to those specific administrative penalties enumerated within the Act.⁵³

The New Jersey Act, however, does contain an safe harbor provision, although it entails only ability to correct clerical or mathematical errors in calculating whether a loan is “covered” under the Act.⁵⁴ Under the New Jersey Act:

a creditor in a home loan who, when acting in good faith, fails to comply with the provisions of this act will not be deemed to have violated this act if the creditor establishes that either: (1) within 45 days of the loan closing, the creditor has made appropriate restitution to the borrower, and appropriate adjustments are made to the loan; or (2) within 90 days of the loan closing and prior to receiving any notice from the borrower of the compliance failure, and the compliance failure was not intentional and resulted from a *bona fide* error notwithstanding the maintenance of procedures reasonably adopted to avoid such errors, the borrower is

⁵¹ 63 PA. STAT. ANN. § 456.522.

⁵² LEVY, *supra* note 23, at 2.

⁵³ 63 PA. STAT. ANN. § 456.521(d). *See generally* Section 456 of the Pennsylvania Act.

⁵⁴ N.J. STAT. ANN. § 46:10B-29(8)(c).

notified of the compliance failure, appropriate restitution is made to the borrower, and appropriate adjustments are made to the loan.⁵⁵

Examples of *bona fide* errors under the New Jersey Act include clerical, calculation, computer malfunction, and programming and printing errors.⁵⁶ However, an error in legal judgment is not considered a *bona fide* error under the Act.⁵⁷ This section of the New Jersey Act rightly begs the question as to what constitutes (1) *appropriate* restitution to the borrower, (2) *appropriate* adjustments to the loan, and (3) the maintenance of procedures *reasonably* adopted to avoid errors. At present there is no guidance in the statute to answer this question, and it will likely become the responsibility of a New Jersey judge to interpret the statute, should it remain in its current form.⁵⁸ The vagaries within this subsection of the New Jersey Act, as compared with the Pennsylvania Act, again reinforce the difficulty in both interpreting the statute, as well as in quantifying the risk in originating a subprime mortgage loan in New Jersey.

E. Assignee Liability

The final distinction between Pennsylvania and New Jersey's anti-predatory lending legislation revolves around the issue of assignee liability for home loans originated in each state.⁵⁹ Under Pennsylvania's anti-predatory lending law, there can be no assignee liability because the statute specifically states that the penalties enumerated in Section 456.521 of the Act

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ These terms are not defined or explained further in the New Jersey Act, nor were they addressed in the clarification bulletin issued on July 29, 2003 by the Department of Banking and Insurance for the State of New Jersey; *See* N.J. Dept. of Banking and Ins. Bulletin No.03-15 *supra* note 30, at 7.

⁵⁹ Assignee liability refers to the liability of purchasers of mortgages in the secondary market, or investors in residential mortgage-backed securities which are available to both retail and institutional customers.

are the “sole and exclusive remedies for any violation of any provision of this chapter.”⁶⁰ Furthermore, the Act also states very clearly that “persons engaged in the purchase, sale, assignment, securitization or servicing of covered loans shall not be held liable for the action or inaction of persons originating such loans.”⁶¹ As evidence of the fact that the Pennsylvania law excludes assignee liability from the available remedies under the Act, there has been no action on the part of any rating agency to either lower the ratings on Pennsylvania residential mortgage-backed securities, or refuse to rate them entirely.⁶² Finally, as the potential for assignee liability stemming from violations of the Pennsylvania Act has been eliminated by statute, the likelihood of class actions is equally remote.

Potentially unlimited assignee liability exists under the New Jersey Act, however, because the applicable provisions of the Act generally subject purchasers and assignees to the same claims and defenses that a borrower could assert against the original creditor.⁶³ Under Section 46:10B-27(6)(b) of the New Jersey Act, “any person who purchases or is otherwise assigned a high-cost home loan shall be subject to all affirmative claims and defenses with respect to the loan that the borrower could assert against the original creditor or broker of the loan.”⁶⁴ However, an assignee will not be liable under the Act if it can demonstrate that a “reasonable person exercising reasonable due diligence” could not determine that the mortgage

⁶⁰ 63 PA. STAT. ANN. § 456.522(b). Home-loan customers may always sue the lenders and brokers for material violations of the Pennsylvania Act.

⁶¹ *Id.*

⁶² Neither Moody’s, Fitch Ratings, nor Standard & Poor’s have issued any press releases regarding changes to residential mortgage-backed securities originated within the Commonwealth of Pennsylvania.

⁶³ *Preemption of New Jersey Predatory Lending Act, supra* note 11.

⁶⁴ N.J. STAT. ANN. § 46:10B-27(6)(b). The only appreciable difference between a “high-cost” home loan and a “covered” loan under the New Jersey Act is that a “high-cost” home loan must not exceed \$350,000. *See infra* note 19.

was a high-cost home loan.⁶⁵ To that end, a purchaser or assignee will be presumed to have exercised reasonable due diligence if it is able to demonstrate by a preponderance of evidence that it:

(1) has in place at the time of the purchase or assignment of the loan, policies that expressly prohibit its purchase or acceptance of assignment of any high-cost home loan; (2) requires by contract that a seller or assignor of home loans to the purchaser or assignee represents and warrants to the purchaser or assignee that either (a) it will not sell or assign any high-cost home loan to the purchaser or assignee or (b) that the seller or assignor is a beneficiary of a representation and warranty from a previous seller or assignor to that effect; and (3) *exercises reasonable due diligence at the time of the purchase or assignment of home loans* or within a reasonable period of time thereafter intended by the purchaser or assignee to prevent the purchaser or assignee from purchasing or taking assignment of any high-cost home loan.⁶⁶

Based upon the conjunctive nature of this test, an assignee will have exercised reasonable due diligence under the Act, and will thus not be liable to a borrower, when it exercises reasonable due diligence to prevent the purchasing of any high-cost home loans.⁶⁷ The circular and ambiguous reasoning of this key subsection of New Jersey Act demonstrates why rating agencies

⁶⁵ *Id.*

⁶⁶ *Id.* [italics added].

⁶⁷ According to Section 46:10B-27(6)(b) of the New Jersey Act, an assignee must satisfy all three elements to avoid liability. Looking exclusively at the third element, the imprecise wording of the statute takes on significance because the standard for assignee liability is essentially incomprehensible. It effectively states that an assignee will have exercised reasonable due diligence when it exercises reasonable due diligence.

cannot quantify how much risk to assignees is involved in New Jersey home loans, and thus will not rate any residential mortgage-backed securities containing them.⁶⁸

III. CONCLUSION

The challenge in drafting legislation to contend with predatory lending in the subprime mortgage markets has always centered around the need to make home loans available to credit-impaired borrowers, while at the same time protecting those citizens from a litany of abusive lending practices. The Pennsylvania Act, which was drafted in part to preempt a severe anti-predatory lending ordinance passed by the City of Philadelphia in the spring of 2001, represents such a balanced effort.⁶⁹ Again, its “Legislative findings” section affirmatively states that regulations “affecting the subprime market should not be overly broad and should restrict only those relatively few lenders who are engaged in patterns of unfair treatment to vulnerable consumers.”⁷⁰ The New Jersey Act, however well-intentioned it may be, poses serious problems for higher-risk borrowers because in its current form those same credit-impaired borrowers the Act purports to protect will be unable to obtain credit of any kind. Unlimited assignee liability, combined with vague compliance procedures, has for all intents and purposes frightened members of the subprime mortgage markets and secondary markets out of New Jersey.⁷¹ As this type of legislative overreaction on the part of other states has recently been preempted by the

⁶⁸ *S&P Surprises Lenders*, *supra* note 9. The possibility for class actions also looms very large for purchasers of securities backed by mortgages originated in New Jersey, especially in light of the New Jersey Department of Banking and Insurance’s recent pronouncement that Section 46:10B-27(a) of the New Jersey Act “provides that a borrower may assert all affirmative claims against the creditor, any assignee or holder in any capacity. *This provision does not restrict the ability of a borrower to raise class action claims.*” [emphasis added]. *See infra* note 30, at 6.

⁶⁹ *See generally* Leonard A. Bernstein, *Philadelphia's New "Predatory Lending" Law: What Every Lender Must Know*, 118 BANKING L.J. 445, 445-57 (2001).

⁷⁰ 63 PA. STAT. ANN. § 456.502(3).

⁷¹ Joshua Brustein, *PredatorAnalyzer Implemented*, NAT’L MORTGAGE NEWS, May 26, 2003, available at 2003 WL 7685528.

OCC and OTS with regard to national banks, national savings associations and their respective operating subsidiaries, a similar fate may await the New Jersey Act.⁷² Therefore, to avoid the burdens of complying with a “hodgepodge of conflicting and overlapping state lending requirements,” the federal government can be expected to eventually preempt state anti-predatory lending laws like that in New Jersey, and establish a balanced, uniform set of regulations like those under the Pennsylvania Act and HOEPA.⁷³

72 Federal preemption of New York and Georgia’s anti-predatory lending laws are the most prominent examples. *See generally* OCC Working Paper: Economic Issues in Predatory Lending, *supra* note 5 (explaining the constitutional and practical issues involved with federal preemption of state and local anti-predatory lending laws).

73 *Preemption of New Jersey Predatory Lending Act*, *supra* note 11, at 6.