Preemption of New Jersey Predatory Lending Act

Summary Conclusion: Federal law preempts application of various provisions of the New Jersey Home Ownership Security Act of 2002 (the Act), as well as the Act's multifaceted compliance scheme, to federal savings associations and their operating subsidiaries. Purchasers of loans originated by a federal savings association would be subject only to the same claims and defenses that would apply to the federal savings association that originated the loan.

Date: July 22, 2003

Subjects: Home Owners' Loan Act/Savings Association Powers

P-2003-5

Office of Thrift Supervision
Department of the Treasury
Chief Counsel
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

July 22,2003

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Re: Preemption of New Jersey Predatory Lending Act

Dear [ ]:

This responds to your recent letter on behalf of ("Association"), a federal savings association that makes residential real estate loans only in New Jersey. In your letter, you request a legal opinion on whether federal law preempts applying the recently enacted New Jersey Home Ownership Security Act of 2002 ("NJ Act"), including its compliance scheme, to federal savings associations.[1] You also ask whether purchasers or assignees of loans a federal savings association originates would be subject to claims and defenses that would not apply to the federal savings association itself.

We conclude that NJ Act provisions purporting 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. We also conclude that the NJ Act's multifaceted compliance scheme is preempted for federal savings associations. We further conclude that those who purchase or are assigned loans originated by a federal savings association would be subject only to the same claims and defenses that would apply to the federal savings association that originated the loan.[2]

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[1] N.J. Stat. Ann § 46:10B-22 *et seq.* The statute takes effect at the end of November 2003.

[2] The same conclusions would apply to federal savings association operating subsidiaries and the loans they originate. OTS has consistently concluded that state laws purporting to regulate the activities of a federal savings association's operating subsidiary are preempted by federal law to the same extent such laws are preempted for the federal savings association itself. *See* 12 C.F.R. § 559.3(n)(1) (2003); OTS Ops. Chief Counsel (January 30, 2003, January 21, 2003, and July 26, 1999).

Background

The restrictions and requirements the NJ Act imposes on creditors differ depending on whether a loan is a "home loan," a "covered home loan," or a "high-cost home loan."[3] All "home loans" are subject to certain provisions regulating the terms of credit, loan-related fees, disclosures, and processing, originating and servicing mortgages. These include (1) prohibiting single premium financing of credit insurance, debt cancellation coverage, or suspension coverage (NJ Act § 46:10B-25(a)); (2) prohibiting the encouragement of default (NJ Act § 46:10B-25(c)); (3) prohibiting acceleration of the indebtedness at the creditor's sole discretion (NJ Act § 46:10B-25(e)); (4) prohibiting charges for payoff balance fees (NJ Act § 46:10B-25(f)); and (5) limiting late payment fees (NJ Act § 46:10B-25(d)).

One provision deals specifically with "covered home loans." It limits the number of times a loan may be refinanced and the circumstances in which a refinancing may occur when an existing home loan is refinanced with a covered home loan. NJ Act § 46:10B-25(b).

"High-cost home loans" are subject to all of these restrictions and requirements, plus numerous other provisions regulating the terms of credit, loan-related fees, disclosures, processing, originating, and servicing mortgages, and disbursements. These include (1) prohibiting balloon payments, negative amortization, increases in the interest rates after default, and fees to modify, renew, extend, or amend a high-cost home loan or defer a payment (NJ Act § 46:10B-26(a)–(c) and (i)); (2) prohibiting points and fees for refinancings of high-cost home loans (NJ Act § 46:10B-26(j)); (3) limiting the financing of points and fees for high-cost home loans (NJ Act § 46:10B-26(l)); (4) limiting the number of advance payments from loan proceeds (NJ Act § 46:10B-26(d)); (5) requiring creditors to provide special disclosures to borrowers with high-cost home loans (NJ Act § 46:10B-26(f)); (6) requiring borrowers to attend loan counseling before the creditor may make the loan (NJ Act § 46:10B-26(g)); and (7) restricting payments of loan proceeds to home improvement contractors (NJ Act § 46:10B-26(h)).

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[3] NJ Act § 46:10B-24 defines these terms. A "home loan" is an extension of credit primarily for personal, family or household purposes, including an open-end credit plan but excluding a reverse mortgage, if the loan is secured by a (1) mortgage or 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 "covered home loan" is a home loan for which the points and fees exceed a specified threshold. A "high-cost home loan" is a home loan for which the principal amount of the loan does not exceed $350,000 (an amount adjusted annually) and for which the points and fees exceed a specified threshold. The term "creditor" is defined functionally rather than by charter type; there is no exception for federal savings associations. NJ Act § 46:10B-24.

The NJ Act contains a multifaceted compliance scheme. A borrower may bring a civil action for a violation of the NJ Act. NJ Act §§ 46:10B-27(c) and 46:10B-29. Statutory and punitive damages, as well as costs and attorneys fees, are available in any such action. NJ Act § 46:10B-29. A borrower may also be granted injunctive, declaratory, and such other equitable relief as a court deems appropriate. NJ Act § 46:10B-29(b)(2).

A violation of the NJ Act also constitutes an unlawful practice under the NJ Consumer Fraud Act ("NJCFA"), which allows for legal and equitable relief, treble damages, as well as costs and attorneys' fees.[4] Instead of seeking damages under the NJ Act, a borrower may bring a civil action under the NJCFA. NJ Act § 46:10B-29(b).

The NJ Act also uses state foreclosure law as a tool to compel compliance. The NJ Act requires a creditor to use the judicial foreclosure procedures where the loan is high-cost and the property is located in NJ, effectively barring the use of deed-in-lieu foreclosures for high-cost loans. NJ Act § 46:10B-26(k). A violation of the NJ Act is also a foreclosure defense as against the creditor or any subsequent holder or assignee. NJ Act § 46:10B-27(c).[5]

Finally, the NJ Act contains a provision that generally subjects purchasers and assignees to the same claims and defenses that a borrower could assert against the original creditor. An exception is that if the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising reasonable due diligence could not determine that the mortgage was a high-cost home loan, then those claims and defenses do not apply. NJ Act § 46:10B-27(b).

Discussion

The NJ Act provisions discussed above, 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

[4] N.J. Stat. Ann. § 56:8-1 *et seq.* (Westlaw 2003).

[5] Another component of the compliance scheme is administrative enforcement by the NJ Department of Banking and Insurance under the New Jersey Licensed Lenders Act ("NJLLA"), N.J. Stat. Ann. § 17:11C-1 *et seq.* (Westlaw 2003). NJ Act § 46:10B-28. However, federal savings associations are exempt from this aspect of enforcement. N.J. Stat. Ann. §§ 17:11C-4 and 17:11C-5 (Westlaw 2003).

savings associations.[6] In enacting the Home Owners' Loan Act ("HOLA"),[7] Congress required the Federal Home Loan Bank Board ("FHLBB"), and now the OTS, to provide for the organization, incorporation, examination, operation, and regulation of federal savings associations "giving primary consideration of the best practices of thrift institutions in the United States."[8] Consistent with this language, OTS has made clear in its lending regulations its intent to carry out this congressional objective by giving federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation.[9] That uniform federal scheme occupies the field of regulation for lending activities. The comprehensiveness of the HOLA language demonstrates that Congress intended the federal scheme to be exclusive, leaving no room for state regulation, conflicting or complementary.[10]

OTS occupies the field to enhance safety and soundness and enable federal savings associations to conduct their operations in accordance with best practices by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden.[11] Under 12 C.F.R. § 560.2(a), federal savings associations may extend credit as authorized under federal law without regard to state laws purporting to regulate or otherwise affect their credit activities. As described above, the NJ Act imposes a number of specific restrictions and requirements on home lending. The NJ Act would regulate

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[6] As per a July 16, 2003 telephone discussion between you and OTS staff, however, this opinion does not address the restriction on mandatory arbitration clauses that renders unconscionable and void any provision that allows a party to require a borrower to assert any claim or defense in a forum that is less convenient, more costly or more dilatory for the resolution of a dispute than a judicial forum in New Jersey. NJ Act § 46:10B-26(e).

This opinion also does not specifically address the provision that subjects creditors, assignees, and holders to the same claims and defenses as a borrower could assert against a seller or home improvement contractor under certain circumstances, including where a contractor refers the borrower to the creditor. NJ Act § 46:10B-27(a). Whether the NJ Act's provision is preempted, however, depends in large part on how it might ultimately be implemented. On its face, the provision appears likely to interfere with the ability of federal savings associations to originate mortgages under a uniform federal system contrary to 12 C.F.R. § 560.2(a) and to impose requirements on the processing and origination of mortgages contrary to 12 C.F.R. § 560.2(b)(10). If so, it would be preempted for federal savings associations. However, if the provision were narrowly construed simply to subject federal savings associations purchasing or taking assignments of loans originated by creditors other than federal savings associations to the same claims and defenses applicable to the originating creditors, we would not be inclined to opine about federal preemption of the provision.

[7] 12 U.S.C.A. § 1461 *et seq.* (West 2001 & Supp. 2003).

[8] HOLA § 5(a); 12 U.S.C.A. § 1464(a) (West 2001 & Supp. 2003).

[9] 12 C.F.R. § 560.2(a) (2003).

[10] *See Fidelity Federal Savings and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982); *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 31 (1996).

[11] 12 C.F.R. § 560.2(a) (2003).

areas covered by § 560.2 and therefore does not apply to federal savings associations' home lending.

OTS has described with specificity the scope of its occupation of the field of lending regulation by noting the types of state laws encompassed within the preemption. They include many of the types of provisions found in the NJ Act. For example, 12 C.F.R. § 560.2(b)(4) preempts state laws on terms of credit, § 560.2(b)(5) preempts state laws on loan-related fees, § 560.2(b)(9) preempts state laws on disclosure, § 560.2(b)(10) preempts state laws on processing, origination, servicing, sale, purchase, investment, and participation in mortgages, and § 560.2(b)(11) preempts state laws on disbursements. This conclusion is further supported by numerous opinions of OTS, and its predecessor, the FHLBB.[12]

The NJ Act would thwart the more general congressional objective that OTS have exclusive responsibility for regulating the operations of federal savings associations "giving primary consideration of the best practices of thrift institutions in the United States."[13] Congress gave OTS, not the States, the task of determining the best practices for federal savings associations and creating nationally uniform rules. OTS conducts regular examinations of thrift lending operations for safety and soundness and compliance with established consumer protections. OTS also maintains a toll-free consumer hotline to respond to consumer questions and complaints. OTS seeks to assure that the thrift appropriately responds to the consumer's concern. If OTS's review indicates a violation of federal consumer laws or regulations occurred, OTS may require the institution to take appropriate corrective action.

Federal savings associations must comply with the requirements of federal law, including restrictions on abusive practices such as those in the Home Ownership Equity Protection Act ("HOEPA") and its implementing regulations.[14] Subjecting federal

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[12] *See, e.g.*, OTS Op. Chief Counsel (January 30, 2003) (preemption of New York predatory lending law); OTS Op. Chief Counsel (January 21, 2003) (preemption of Georgia predatory lending law); OTS Op. Counsels (Banking and Finance) (May 16, 2001) (preemption of state law on terms of credit); FHLBB Op. Gen. Counsel (February 1, 1982) (same); OTS Ops. Chief Counsel, (December 14, 2001, April 21, 2000, and March 10, 1999) (preemption of state law on loan-related fees); OTS Op. Chief Counsel (December 24, 1996) (preemption of state law on loan-related fees and disclosures); OTS Mem. Dep. Chief Counsel (May 10, 1995) (preemption of state law on disclosures). With respect to the limitation on late payment fees in NJ Act § 46:10B-25(d), we further note that federal savings associations are expressly authorized to impose late charges. 12 C.F.R. § 560.33 (2003).

[13] 12 U.S.C.A. § 1464(a) (West 2001 & Supp. 2003).

[14] *See* 15 U.S.C.A. § 1639 (Westlaw 2003); 12 C.F.R. pt. 226, subpart E (2003). We note that the Federal Trade Commission's Holder In Due Course Rule, 16 C.F.R. pt. 433, would appear to apply to some of the types of home loans covered by the NJ Act. NJ Act § 46:10B-27(a), discussed above on page 4, footnote 6, draws concepts from that rule. To the extent that rule applies to federal savings association operating subsidiaries, they must comply with the rule.

savings associations to the burdens of complying with a "hodgepodge of conflicting and overlapping state lending requirements" would undermine the federal objective of permitting federal savings associations to exercise their lending powers "under a single set of uniform federal laws and regulations. This [uniformity] furthers both the 'best practices' and safety and soundness objectives of the HOLA by enabling federal thrifts to deliver low-cost credit to the public free from undue regulatory duplication and burden."[15]

You also ask whether the NJ Act's multifaceted compliance scheme, including the potential threat of litigation and application of the foreclosure provisions, is preempted for federal savings associations.[16] The NJ Act's compliance scheme could not be applied to federal savings associations in a manner that would compel them to comply with the preempted provisions, including intrusive lending restrictions. Such a result would have more than an incidental affect on the lending operations of federal savings associations and would run contrary to HOLA's purpose of allowing federal savings associations to exercise their lending powers in accordance with a uniform federal scheme.[17]

You further ask whether purchasers or assignees of loans originated by federal savings associations would be subject to claims and defenses that would not apply to the federal savings association that originated the loans. On its face, the NJ Act only subjects purchasers and assignees to the same claims and defenses that a borrower could assert against the original creditor. Even to that limited extent, the purchaser or assignee is not subjected to those claims and defenses if it demonstrates, by a preponderance of the evidence, that a reasonable person exercising reasonable due diligence could not determine that the mortgage was a high-cost home loan. NJ Act § 46:10B-27(b). As discussed above, where the original creditor is a federal savings association, the borrower's ability to assert claims and defenses against that type of creditor is limited by

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[15] 61 Fed. Reg. 50,951, 50,965 (Sept. 30, 1996) (Final Rule: Lending and Investment).

[16] As discussed above, one component of the compliance scheme is administrative enforcement by the State for persons licensed under or subject to the NJLLA. While the NJLLA contains an exemption for federal savings associations, it does not contain an exemption for their operating subsidiaries. However, OTS has previously concluded that under principles of federal preemption federal savings association operating subsidiaries are not subject to the NJLLA. OTS Op. Chief Counsel (August 19,1997).

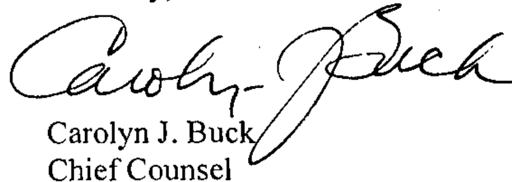
[17] *See* 12 C.F.R. § 560.2(a) (2003). Certain types of state laws, such as real property laws, are not preempted to the extent that they only incidentally affect the lending operations of federal savings associations or are consistent with HOLA's purposes. *See* 12 C.F.R. § 560.2(c) and (c)(2) (2003). The NJ Act's foreclosure provisions, however, would not appear to fit that description since they would be used to compel compliance with the lending restrictions in the NJ Act. *Accord* OTS Op. Chief Counsel (January 30, 2003) (preemption of compliance scheme under New York predatory lending law as applied to federal savings associations).

federal preemption. Thus, the NJ Act would appear to make the borrower's ability to assert claims and defenses against purchasers and assignees similarly limited.[18]

In reaching the foregoing conclusions, we have relied on the factual representations made in the material you submitted to us as summarized herein. Our conclusions necessarily depend on the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions.

We trust that this is responsive to your inquiry. If you have further questions, please contact Richard Bennett, Counsel (Banking and Finance), at (202) 906-7409.

Sincerely,



Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel

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[18] This result would be consistent with the general principle that loan terms should not change simply because an originator entitled to federal preemption may sell or assign a loan to an investor that is not entitled to federal preemption. *See, e.g.*, FHLBB Op. General Counsel (August 13, 1985) (state law requiring the payment of interest on escrow accounts is preempted for loans originated by federal savings associations regardless of whether the loans are later sold to an entity other than a federal savings association); S. Rep. No. 96-368 (1979) at 19, 1980 U.S.C.C.A.N. 236, 254-255 (legislative history of section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980, currently codified at 12 U.S.C.A. § 1735f-7a (West 2001), expressing Congress's intent that "loans originated under this usury preemption will not be subject to claims of usury even if they are later sold to an investor who is not exempt" cited in FHLBB Op. General Counsel (February 4, 1986)). If this provision of the NJ Act is ultimately interpreted and applied in a different manner, however, it might interfere with the ability of federal savings associations to sell mortgages that they originate under a uniform federal system and, thus, be subject to preemption.