



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF BANKING
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HARRISBURG, PENNSYLVANIA 17101-2290

JAMES B. KAUFFMAN, JR.
SECRETARY OF BANKING

August 17, 2001

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TO: All Pennsylvania State-Chartered Banks, Bank and Trust Companies, Savings Banks, Savings Associations, and Credit Unions; Mortgage Lenders and Mortgage Brokers Licensed Under or Otherwise Subject to the Mortgage Bankers and Brokers Act and/or the Secondary Mortgage Loan Act; Consumer Discount Companies Licensed under the Consumer Discount Company Act; National Banks, Federal Savings Associations, and Federal Credit Unions Headquartered or with one or more branch offices in Pennsylvania.

This letter is to announce to you that on **June 25, 2001**, Governor Ridge signed into law as **Act 55 of 2001, the Mortgage Bankers and Brokers and Consumer Equity Protection Act (the "Protection Act")**, S.B. 377 of 2001, (P.N. 1240), which was approved by the General Assembly on June 21, 2001, by votes of 152-41 in the State House and 43-4 in the State Senate. The Protection Act addresses what is generally known as "predatory lending" in Chapter 5, as well as revisions to the preexisting residential first mortgage lenders and brokers licensure statute recodified as Chapter 3. More specifically, the Protection Act is divided into chapters numbered: 1 ("Preliminary Provisions" - name of statute and definition of the Pennsylvania Department of Banking as the "Department"); 3 ("Licensure" - continuing the former Mortgage Bankers and Brokers Act, with amendments); and 5 ("Consumer Equity Protection" - new restrictions against predatory lending).

Recommendations for Your Financial Institution; Department Action: I strongly recommend that you consider how the new Protection Act impacts your financial institution's subprime lending business, to the extent your institution engages in originating or brokering such loans, and prepare to comply with the Protection Act's provisions. I further recommend that your financial institution seek legal advice regarding Act 55 of 2001 from your institution's legal counsel. Until Predatory Lending Chapter 5 becomes effective, the Department will continue to follow-up on consumer complaints, and to conduct targeted examination and enforcement activity against predatory lending under laws presently within the Department's jurisdiction to enforce. Before and after Predatory Lending Chapter 5 becomes effective, the Department will continue to enforce all laws within its jurisdiction to enforce including those that may be considered applicable to predatory lending types of lender or broker activities. A summary of Act 55 of 2001 is enclosed for your convenience.

The Department recognizes that Chapter 5, except for section 504(a)(prohibition against local banking laws), is not legally effective until June 25, 2002. Accordingly, the Department understands that it may not enforce or impose penalties for violations of Chapter 5 until that time. Nevertheless, **the Department strongly encourages financial institutions to comply with the**

rules in Predatory Lending Chapter 5 as soon as possible in advance of the June 25, 2002 effective date upon which compliance becomes mandatory. During present examinations, the Department will look for and point out deficiencies under Chapter 5 in an effort to help you prepare to comply with Act 55 of 2001.

Regarding Chapters 1 (Preliminary Provisions) and 3 (Licensure) of the Protection Act, the Department will continue its ongoing licensing, examinations, and enforcement of the Former Act in its present form and, beginning August 24, 2001, in its newly revised and amended Chapters 1 and 3 forms, as applicable to residential first mortgage nondepository lenders and brokers.

This letter is not intended as and does not constitute legal advice. This letter contains generalizations regarding Act 55 of 2001 and therefore is not inclusive of all of its provisions, conditions, exceptions, and details.

Finally, the Department is committed to enforcing the Protection Act for purposes of consumer protection against unsavory practices that may be committed by a relatively few depository or nondepository mortgage lenders and brokers operating in the subprime lending market in Pennsylvania. Accordingly, the Department encourages full compliance with the provisions of the Protection Act that may be applicable to your financial institution. If you have any compliance questions, please do not hesitate to contact Richard S. DeMartino, Director of the Bureau of Supervision and Enforcement regarding depository institutions, at 717-783-8240, or Victor H. Seesholtz, Chief of Compliance in the Bureau of Licensing and Consumer Compliance regarding licensees, at 717-772-3889.

Sincerely,

A handwritten signature in black ink, appearing to read "Victor H. Seesholtz", written in a cursive style.

Enclosure:

Summary of Act 55 of 2001

SUMMARY OF ACT 55 OF 2001

This Summary of Act 55 of 2001 will address Predatory Lending Chapter 5 first. Unlike Licensure Chapter 3 that is applicable primarily to nondepository institutions required to be licensed to originate or broker residential first mortgage loans, Predatory Lending Chapter 5 is applicable to both depository and nondepository lenders and brokers originating or brokering certain high cost home equity loans in Pennsylvania. Also, unlike Licensure Chapter 3, **Predatory Lending Chapter 5 is completely new law.**

I. Restrictions Against "Predatory Lending" (Chapter 5): The entirely new State law provisions in Chapter 5 are designed to "restrict only those relatively few lenders [in the subprime lending market] who are purposefully engaged in patterns and practices of unfair treatment to vulnerable consumers commonly referred to as predatory lending." (Section 502.)

Chapter 5 is State law that specifically and broadly prohibits localities from enacting and enforcing local banking laws that pertain to the financial or lending activities of persons subject to the jurisdiction or regulatory supervision of the Department, the federal banking regulatory agencies (the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration), the Federal Trade Commission, or the U.S. Department of Housing and Urban Development. (Section 504(a).)

Chapter 5 is applicable to both depository and nondepository lenders and brokers of closed-end home equity mortgage loans, involving property located in Pennsylvania, of any lien position in principal amounts of less than \$100,000 made at a high cost, generally meaning the rate and point triggers in the federal Home Ownership Equity Protection Act ("HOEPA"). Those rate and point triggers are (i) an annual percentage rate exceeding 10 percentage points above comparable term U.S. Treasury securities, and/or (ii) total points and fees payable by the consumer at or before closing that exceed the greater of 8 percent of the total loan amount or \$400.00, the latter monetary amount of which is adjusted annually by the annual percentage change in the Consumer Price Index and for the year 2002 is \$480.00 according to the Federal Reserve. These loans are referred to as "covered loans" in the Protection Act. (Section 503.) If HOEPA's rate or point triggers are changed, then the definition of "covered loan" in the Protection Act changes automatically. Loans with an original principal balance of \$100,000 or more are not subject to the requirements of the Protection Act, even if such loans are subject to HOEPA.

Certain loan terms are prohibited or conditionally restricted in connection with a covered loan, such as: (i) balloon payments, (ii) call provisions, (iii) negative amortization, (iv) increased interest rate upon default, and (v) prepayment fees or penalties. (Section 511.)

Certain acts or practices are prohibited, conditionally restricted, or required in connection with a covered loan, including the following:

- (i) a cautionary notice, in writing, is required to be provided by the lender to the borrower at least three business days prior to consummation of the mortgage transaction;

(ii) it is impermissible to engage in a pattern or practice of making covered loans without due regard to the consumer's ability to repay the loan;¹

(iii) there are restrictions on a lender refinancing an existing covered loan held by the lender with a new covered loan such that no points may be charged to the extent the proceeds are used to refinance the existing covered loan if the most recent financing was within one year;

(iv) a lender may not refinance a zero interest rate or low-rate loan made by a governmental or nonprofit lender with a covered loan unless the loan is at least ten years old or the current holder of the loan consents to the refinancing;

(v) a lender may not pay proceeds from a covered loan directly to a home improvement contractor but instead must disburse the loan proceeds through an instrument payable to the obligor (statutorily defined as the person obligated to repay a covered loan) individually or jointly with the contractor or, at the obligor's election through a third party escrow agent in accordance with the terms of a written agreement signed by the obligor, lender, and home improvement contractor prior to disbursement of funds to the contractors;

(vi) a lender may not sell single premium credit insurance in connection with a covered loan unless the lender offers the obligor the option of purchasing all such credit insurance on a monthly basis (compliance with this provision is required by 18 months to 2 years after Chapter 5 was enacted on June 25, 2001);

(vii) a credit insurance notice, in writing, must be provided to the obligor stating that his or her purchase of credit insurance is not a required condition of obtaining the covered loan, and that the obligor may cancel the credit insurance within 30 days of the date of the covered loan in order to receive a full refund (meaning a credit to the loan balance or cash, at the lender or insurance company's discretion);

(viii) lenders and brokers shall maintain records related to covered loans that will facilitate the Department determining compliance with Chapter 5;

(ix) a lender or its servicer shall file quarterly reports of favorable and unfavorable credit history of the obligor with a nationally recognized consumer credit reporting agency, but this requirement shall not prevent the lender or servicer from agreeing with the obligor not to report payment history information related to resolved or unresolved disputes with an obligor, and this provision shall not apply to covered loans held or serviced by a lender for less than 90 days; and

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Lender consideration of the consumer's ability to repay applies under the Protection Act only to obligors whose income is 120% or less of the median family income under the metropolitan statistical area or nonmetropolitan family income statistics. There is a statutory presumption that the obligor can repay the covered loan if monthly payments do not exceed 50% of the obligor's monthly gross income. There is no statutory presumption that the obligor cannot make the payments even if the 50% monthly gross income level is exceeded by the required monthly loan payments.

(x) lenders shall verify that each mortgage broker with whom it does business in connection with covered loans holds the required license to engage in business in Pennsylvania. (Sections 512, 513, 521(b).)

Lenders purposefully engaging in a pattern or practice of material violations of Chapter 5 may be subject to a **civil action** filed by an obligor seeking to recover damages. Persons engaged in the purchase, sale, assignment, securitization, or servicing of covered loans shall not be liable for the action or inactions of persons originating such loans. (Section 522.)

Department Enforcement of Chapter 5: Regarding lender and broker compliance with the provisions in Chapter 5, the **Department** has **enforcement authority, including:** (i) examination and other investigation powers and the ability to charge a fee to recover the costs to the Department of any examination; (ii) report requirements; (iii) license revocation; (iv) imposition of cease and desist orders including requiring restitution for actual damages to obligors; (v) imposition of monetary penalties of up to \$2,000 for each offense, injunctions, or other conditions as the Department deems appropriate; (vi) subpoena power; (vii) permanent removal of individuals from their employment in the mortgage finance industry or in any other capacity related to activities regulated by the Department for being responsible for a violation of any provision in Chapter 5; and (viii) promulgation of regulations and statements of policy to enforce Chapter 5. (Sections 521, 524.)

The **Department is required to publish any final orders**, subject to redaction for confidentiality purposes, that the Department issues to any person in enforcing the provisions of Chapter 5. The **Department may share documentary or other information** with federal or state banking regulatory agencies or Commonwealth agencies **and enter into information sharing agreements** pertaining to enforcement of Chapter 5. (Sections 521(g), 523.)

As required by section 504(d), the **Department shall interpret and apply Chapter 5 to the fullest extent practical in a manner consistent with applicable federal statutes** and regulations, policies, and orders of federal regulatory agencies and shall not deem Chapter 5's provisions to constitute an attempt to override federal law. Federal preemption of any provision of Chapter 5 for any national bank or federal savings bank shall be preemptive to the same extent to their respective operating subsidiaries according to section 504(c). As a general matter, section 504(b) provides that Chapter 5 will be applied by the Department to Pennsylvania state-chartered depository institutions and their subsidiaries to the same extent applied to federal depository institutions and their subsidiaries, consistent with the parity and other authority for Pennsylvania state-chartered banking institutions and their subsidiaries contained in section 201 of the Banking Code of 1965, 7 P.S. § 201. (Section 504.)

Effective Date of Chapter 5: Chapter 5 is applicable in one year, meaning June 25, 2002, except that Section 504(a) (stating that local banking ordinances may not be enacted or enforced by localities or other political subdivisions of this Commonwealth) became effective immediately on June 25, 2001.

II. Separate Amendments to Preexisting Mortgage Bankers and Brokers Act (Chapter 3) Applicable Primarily to Nondepository Lenders and Brokers: Chapter 3 is the already-in-existence former Mortgage Bankers and Brokers Act (**the “Former Act”**) which contains licensure and related statutory provisions applicable primarily to residential first mortgage nondepository lenders and brokers, and is renumbered with the following new amendments:

- (i) clarifying that the \$100,000 bond required of mortgage brokers who accept advance fees from consumers is a penal bond enforceable and subject to forfeiture by the Department;
- (ii) adding that the Department may charge a fee for its review of continuing education programs and providers;
- (iii) authorizing the Department to require criminal history record information from any applicant or licensee or person related in any way to the residential first mortgage loan business, at a cost to be paid by the applicant or licensee;
- (iv) adding a license exemption for any nonprofit corporation making not more than 12 mortgage loans in a calendar year with its own funds for the purpose of promoting the cultural traditions and lifestyles of bona fide religious organizations, provided that it originates the loans with its own funds, does not hold itself out to the public as a first mortgage lender, retains the loans in its own portfolio, and does not regularly sell the loans to others; and
- (v) containing technical amendments including the renumbering necessary to fit the Former Act into Chapter 3 of the new Protection Act. (Sections 303(b)(15), 304(c)(1), 304(e), 310(c)(3).)

Effective Date of Chapter 3: The Former Act remains effective until August 24, 2001, when it becomes effective as the substantively amended and technically renumbered Chapter 3 of the new Protection Act.

III. Preliminary Provisions (Chapter 1): Chapter 1 contains only the title of the new Protection Act and a definition of the Department of Banking as the ADepartment applicable throughout the statute. (Sections 101, 102.)

Effective Date of Chapter 1: Chapter 1 becomes effective at the same time as Chapter 3, meaning August 24, 2001.

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