



# Empire Justice Center

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## **New State Law Addresses Mortgage Foreclosure Crisis and Subprime Lending Abuses**

**By Kirsten Keefe and Elizabeth Hasper**

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On August 5, 2008, Governor Paterson signed into law comprehensive legislation that the New York State Legislature had passed in June, referred by some as the Foreclosure Prevention and Responsible Lending Act. The law provides assistance to homeowners with high-cost, subprime and non-traditional home loans who are in danger of losing their homes.<sup>1</sup> This law also provides consumer protections in the subprime lending industry. Provisions of the new law go into effect at different points in time, starting immediately.<sup>2</sup>

### **Provisions to Help Homeowners in Default and Foreclosure**

#### **Ninety-Day Pre-Foreclosure Notice (adds RPAPL § 1304)**

Starting September 1, 2008, lenders<sup>3</sup> or mortgage loan servicers are required to send homeowners with high-cost,<sup>4</sup> subprime,<sup>5</sup> and non-traditional<sup>6</sup> home loans a notice at least 90

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<sup>1</sup> This law was passed in addition to the allocation of \$25 million in the state budget in 2008 to assist homeowners. The funding will go to non-profit agencies, including housing counselors and legal services, to provide direct assistance to homeowners with subprime loans. The Department of Housing and Community Renewal (DHCR) is charged with dispersing the funds. Requests for proposals are available on the DHCR website at <http://www.nysdhcr.gov/ocd/progs/foreclosure/foreclosure.htm>.

<sup>2</sup> The full text of the legislation can be downloaded off of the Assembly or Senate websites by searching for "A10817" or "S8143."

<sup>3</sup> **Lenders**" refers to a mortgage banker or exempt organization as set forth in Banking Law § 590.

<sup>4</sup> **High cost home loan**" is defined in Banking Law § 6-l as a loan incurred for personal, family or household purposes, secured by a mortgage or deed of trust on real estate upon which there is located or there is to be located a one to four family home or the borrower's principal dwelling. The property must be located in NY and the principal balance cannot exceed the lesser of the conforming loan size limit for a comparable dwelling as established by the federal national mortgage association, or \$300,000. The terms of the loan must exceed one or more thresholds to be considered "high-cost": (1) for first lien loans, the annual percentage rate (APR) exceeds 8 percentage points over the yield on treasury securities having comparable periods of maturity to the loan, measured as the fifteenth day of the month immediately preceding the month in which the application for the loan is made; for subordinate lien loans, the APR exceeds 9 percentage points; and/or (2) total points and fees, as defined by the law, exceed 5% of the loan for conventional loans, or 6% of FHA or VA loans if the loan is \$50,000 or more; or total points and fees exceed the greater of 6% of the loan or \$1,500 for loans less than \$50,000. Open-end credit plans are included though reverse mortgages are excluded.

<sup>5</sup> For purposes of this section, "**subprime home loan**" is defined as a home loan originated between January 1, 2003 and September 1, 2008 where the terms of the loan are in excess of the threshold. Excluded from the definition are construction loans, temporary loans with a term of twelve months or less, and home equity lines of credit. The threshold for a first lien mortgage loan is when the annual percentage rate (APR) of the home loan when originated, exceeds 3 percentage points over the yield on treasury securities which have similar periods of maturity to the loan maturity on the fifteenth day of the month that the loan was created consummated, or exceeds 5 percentage points for subordinate lien loans. If the APR will rise after an introductory period (such as in the typical case of subprime adjustable rate mortgages), the APR to be considered is the one that applies after the introductory period ends. The threshold will be determined based on the listing of constant maturity yields for U.S. Treasury securities, published

days prior to the commencement of a legal action. Notices must be sent to the borrower by registered or certified mail and by first-class mail, to the last known address of the borrower. The date the notice is mailed is the date that the notice is considered to be given.

*Specific and Personalized Information Required:* The exact language required for the notice is set forth in the law.<sup>7</sup> The notice must be in fourteen-point font and must state that as of a specific date, the home loan is “X” number of days in default and that the homeowner is at risk of losing their home. The notice must also state that the homeowner can save their home by making a payment of “X” amount of dollars by a specific date, or may consider another option if they are having financial difficulty. The notice must set forth the telephone number of the lender or mortgage servicer, where the homeowner can contact them directly. The notice also must inform the borrower that it will be more beneficial to take immediate action as it is probable that there will be fewer options available the longer the homeowner waits. If the matter is not resolved in 90 days the lender or mortgage servicer can take action against the homeowner, or sooner, if the property is no longer the mortgagor’s primary residence.

*Referrals to Specified Counseling Services:* One of the primary purposes of the notice is to refer borrowers to agencies that assist homeowners in doing work-outs with lenders, whether it be a loan modification, an easier payment plan, or a period of loan forbearance. The lender or mortgage servicer must attach a list of at least five government approved housing counseling agencies in the homeowner’s geographic region that provide free or low-cost counseling.<sup>8</sup> The notice must also direct the homeowner to call the Banking Department’s Toll-Free Helpline or go to their website for more information.

*Exemptions from the notice requirement:* The 90-day period does not apply to mortgagors in bankruptcy, or if the borrower does not occupy that residence as their principal dwelling. The notice and the ninety-day period must be provided only once per year to the same borrower for the same loan.

*Remedies:* A defendant may raise a violation of this section as a defense to a foreclosure action.

### **Mandatory Settlement Conferences (amends CPLR Rule 3408)**

Under a new CPLR rule effective September 1, 2008, for residential foreclosure actions involving a high-cost home loan created between January 1, 2003 and September 1, 2008, or a subprime,<sup>9</sup> or a nontraditional loan<sup>10</sup> where the defendant is a resident of the property subject to foreclosure, there must be a mandatory conference held by the court, within sixty days after the date proof of service of the foreclosure is filed with the county clerk, or on an adjourned date agreed to by the parties. The purpose of the conference is to determine if the parties can reach an agreement to help the defendant from losing their home.

*Unrepresented homeowners:* If the defendant appears *pro se* at the conference, the homeowner will be deemed to have made a motion to proceed as a poor person pursuant to Section 1101 of the Civil Practice Law and Rules. The court may then assign counsel. The

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on the Banking Department’s website. (The listing will include the securities for all months between January 1, 2003 and September 1, 2008.)

<sup>6</sup> **Non-traditional home loan**” is defined as a payment option adjustable rate mortgage or interest only loan created between January 1, 2003 and September 1, 2008.

<sup>7</sup> The notice is available on Empire Justice Center’s website at <[www.empirejustice.org](http://www.empirejustice.org)>.

<sup>8</sup> Agencies will include U.S. Dept of Housing and Urban Dev. Approved Housing Counseling Agencies or other such agencies as designated by the division of Housing and Community Renewal (DHCR). The list will be provided to lenders by the NYS Banking Department and/or DHCR.

<sup>9</sup> See supra note 5 for definition of “subprime home loan” for purposes of this section.

<sup>10</sup> See supra note 6 for definition of “non-traditional home loan” for purposes of this section

CPLR amendments require the court to advise the *pro se* defendant of the nature of the action and of his or her rights and responsibilities. If counsel is appointed, the conference will be adjourned to a date where the counsel can appear. The plaintiff (mortgagee) may appear in person or by counsel, but if appearing by counsel the representative must be fully authorized to dispose of the case. The court may allow the plaintiff's representative to participate by telephone or video conference.

*Pending foreclosure actions:* For foreclosure actions on subprime or high-cost home loans, which began prior to September 1, 2008, but where there is no final order of judgment, effective as soon as the bill became law, defendants have a right to request a settlement conference. In these cases, the court shall request the plaintiff to identify if the loan is a subprime home loan or a high-cost home loan. Notice will be sent to the defendant by the court letting them know that they can request a settlement conference. When requested, the conference must be held as soon as practicable.

### **Affirmative Allegation of Standing (amends RPAPL §1302)**

Foreclosure complaints filed on or after September 1, 2008 for high-cost and subprime home loans must include an affirmative allegation that at the time the proceeding commenced, the plaintiff was the owner and holder of the subject mortgage and note, or has been delegated authority to institute a foreclosure lawsuit on behalf of the owner and holder. The plaintiff also must aver that they have complied with Banking Law §595-a<sup>11</sup> and its regulations, Banking Law §6-1 and §6-m, and with the ninety day notice provision (RPAPL Sec. 1304).

### **Requirements for “Distressed Property Consultants” (adds Real Property Law §265-b)**

The law adds a provision to RPL §265 to regulate “distressed property consultants” who solicit homeowners in default and foreclosure with the promise of assisting them in negotiating with their lender to save their homes. Fees for the services of these for-profit entities vary, as does the level of service provided. Many New York homeowners have been taken advantage of by members of this growing industry and have lost money that would have been better spent to help cure arrears. Keep in mind, too, that there are already non-profit housing counselors around the state who are professionally trained to assist homeowners for no or little fee.

“Consultants” include anyone who agrees to assist a homeowner in default (on their mortgage or property taxes) with a work-out, responding to a complaint, or a number of other activities related to assisting the homeowner. The definition does not include attorneys, lenders generally, and bona fide not-for-profits such as housing counseling and legal services agencies.

Effective September 1, 2008, there must be a written contract between the consultant and the homeowner that sets forth, in 12 point type, the nature of the service, compensation expected and contact information for the consultant. The contract must be given to the homeowner along with a notice of the homeowner's right to cancel the contract within five days and referring them to non-profit and government agencies. Two copies of a “Notice of Cancellation” form that the homeowner may use to rescind the contract must be given, as well.<sup>12</sup> Consultants are prohibited from receiving payment for services before the full completion of such services, taking power of attorney from the homeowner and retaining original loan documents of the homeowner, among other things.

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<sup>11</sup> Banking Law § 595-a regulates mortgage brokers, mortgage bankers and exempt organizations including the imposition of a fine for the failure to comply with the banking regulations, restrictions on advertising, required disclosures, and restrictions on tying.

<sup>12</sup> The notice of right to rescind, and the “Notice of Cancellation” form are available on Empire Justice's website at [www.empirejustice.org](http://www.empirejustice.org).

*Remedies:* Violation may result in voidance of the contract, as well as actual and consequential damages and costs should the homeowner be harmed. If the violation was intentional or reckless, a court may award treble damages and attorneys' fees. The Attorney General also may bring an action, including an action to enjoin the offender.

### **Amendment to the Notice Required Under the Home Equity Theft Prevention Act (amends RPAPL §1303)**

The law modifies the notice provision of the Home Equity Theft Prevention Act. That law regulates transactions in which equity purchasers offer assistance to homeowners in default or foreclosure by buying their property to payoff the loan and stop the foreclosure. Usually these purchasers promise that the homeowner can continue to live in the property and buy it back over time. The Act prescribes, among other things, that the homeowner receives a portion of the equity in the property, even if the buy-back scenario fails.

The Home Equity Theft Prevention Act requires lenders to send a notice along with the summons and complaint on a separate sheet of colored paper. The purpose of the notice is to warn homeowners in foreclosure that they may be preyed upon by unscrupulous parties, and to refer them to the NYS Banking Department's website for information and referrals to non-profit agencies for assistance. The notice is amended to include a statement regarding the summons and complaint and advising homeowners to immediately contact a lawyer or legal aid office to obtain advice. Language also is added to warn homeowners about a broader array of foreclosure rescue scams. The amended notice must be included with the foreclosure summons and complaint starting September 1, 2008.<sup>13</sup>

### **Prospective Regulation to Prevent Abusive Practices**

#### **High-Cost Home Loans (amends Banking Law § 6-l)**

New York's current anti-predatory lending law, Banking Law § 6-l went into effect in 2003 to regulate "high-cost home loans," that is, loans with excessively high interest rates and/or fees and costs financed up front in the loan.<sup>14</sup> The new law strengthens existing Banking Law § 6-l provisions, and adds additional prohibitions on high-cost home loans.

Changes include a provision to strengthen the current prohibition on making loans that negatively amortize to explicitly prohibit payment option loans.<sup>15</sup> Products sold in connection with and financed by the loan, in addition to insurance, are prohibited as well, and mortgage brokers are added to the prohibition on refinancing of special mortgages. New protections include: no prepayment penalties; a ban on yield spread premiums<sup>16</sup> (unless properly disclosed and used by the borrower to offset up front costs); mandatory disclosure of taxes and insurance payments to the borrower; mandatory inclusion of escrow for taxes and insurance for first lien loans, or for second lien loans if taxes and insurance are not otherwise escrowed;<sup>17</sup> and a ban on "teaser" rates with a duration of six months or less.

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<sup>13</sup> The notice is available on Empire Justice's website at <[www.empirejustice.org](http://www.empirejustice.org)>.

<sup>14</sup> See *supra* note 4 for definition of "high-cost home loan."

<sup>15</sup> Negatively amortizing loans are loans in which the periodic payments are not sufficient to cover the fully amortized principal and interest payment, thereby causing the principal balance to increase, rather than decrease. A payment option loan allows the borrower to choose the monthly payment. The lowest payment option typically is a payment of the monthly interest only, with no payment of principal. Higher payments which include a payment on the principal are available however, these loans are often underwritten to the borrower's ability to pay the interest only payment.

<sup>16</sup> A yield spread premium is a commission paid by a lender directly to the mortgage broker or loan officer arranging the loan, based on the difference in the interest rate in which a borrower would qualify for the loan versus the higher interest rate the borrower is sold.

<sup>17</sup> After one year, borrowers may opt out having their taxes and insurance escrowed if allowed by the lender. For second lien loans, if taxes and insurance are not otherwise escrowed, lenders are not required to escrow if the borrower demonstrates a record of twelve months of timely payments

The new restrictions in Banking Law § 6-l apply to high-cost loans made on after September 1, 2008 *except for* the provision requiring mandatory escrow of taxes and insurance. Lenders are not mandated to escrow taxes and insurance until July 1, 2010. At that time, the notice already required by Banking Law § 6-l, given to borrowers at least ten days prior to closing, will be amended to delete current language that tells borrowers that they may be separately responsible for tax and insurance payments.<sup>18</sup>

*Remedies:* Remedies for violations of Banking Law § 6-l remain the same. These include actual, consequential and incidental damages, statutory damages, rescission, injunctive, declaratory or other equitable relief, and attorneys' fees, depending on the nature of the violation. Defendants may raise violations as a defense to a foreclosure action, as well. The Attorney General and Superintendent of the Banking Department ("Superintendent") are authorized to enforce the law.

### **Subprime Home Loans (adds Banking Law §6-m)**

The law sets forth new prohibitions and regulations for "subprime home loans,"<sup>19</sup> effective September 1, 2008. Generally the prohibitions and regulations are the same as set forth for "high-cost home loans" with a few differences.<sup>20</sup> Remedies differ, as well.

When making a subprime loan, a lender is prohibited from including the following provisions in the loan terms: "call" provisions which would allow the lender to accelerate the indebtedness (other than for default); an increase in the interest rate if the borrower defaults; oppressive mandatory arbitration clauses; kickbacks or other payments to mortgage brokers for services not rendered, or not reasonably related to the value of good or services; yield spread premiums that do not offset up front costs and are not properly disclosed; prepayment penalties; and teaser rates with a duration of less than six months.

The following practices are also prohibited: making loans that negatively amortize, including payment option loans; financing insurance or other products unrelated to loan; financing large advancements to pay future monthly payments; refinancing special mortgages; loan flipping; encouraging default; and charging modification or deferral fees unless the modification is part of workout process. Lenders must provide borrowers a counseling notice with a list of counselors, similar to the notice provided for "high-cost" loans, and must disclose the taxes and insurance payment amount the first time the borrower is told the monthly payment amount. Starting July 1, 2010, lenders will be required to escrow for taxes and insurance.<sup>21</sup>

A lender making a subprime loan must verify that the borrower has the ability to repay the loan, taking into account escrow payments, current and expected income, credit history, current obligations, employment status and other financial resources apart from the home. If the loan is an adjustable rate mortgage (ARM), payment ability must be based on the monthly payment calculated at the fully indexed rate.<sup>22</sup>

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<sup>18</sup> The notice is available on Empire Justice's website at <[www.empirejustice.org](http://www.empirejustice.org)>.

<sup>19</sup> For purposes of this section, "subprime home loan" is defined as a home loan in which the fully indexed annual percentage rate exceeds more than one and three-quarters (1.75) percentage points for first-lien loans, and three and three-quarters percentage points (3.75) for subordinate lien loans, the average commitment rate for loans in the northeast region with a comparable duration (as published by the Federal Home Loan Mortgage Corporation (Freddie Mac) in its weekly primary mortgage market survey (PMMS), as posted the week prior to the week the lender receives the loan application. Subprime home loans do not include construction, bridge loans with a term of twelve months or less, or home equity lines of credit. The "fully indexed rate" applies to adjustable rate mortgages that have an initial fixed interest rate that adjusts, based on a market index, after a period of time. The "fully indexed rate" is calculated by determining the index at the time of loan origination and adding the margin set forth in the Note.

<sup>20</sup> A chart of prohibitions and limitations set forth in Banking Law § 6-l and § 6-m for "high-cost" and "subprime" home loans, respectively, is available on Empire Justice's website at <[www.empirejustice.org](http://www.empirejustice.org)>.

<sup>21</sup> After one year, borrowers may opt out of the escrow payment. See *supra* note 17.

<sup>22</sup> See *supra* note 19 for an explanation of "fully indexed rate."

Subprime home loans must include a legend at the top in 12 point font that the mortgage is a subprime home loan subject to Banking Law § 6-m. Lenders are explicitly prohibited from splitting loans or otherwise attempting in bad faith to avoid coverage under the act.

*Remedies:* Borrowers are entitled to actual damages for violations of Banking Law § 6-m, and may also be awarded injunctive, declaratory and such other equitable relief the court deems appropriate in an action to enforce compliance with this the law. Borrowers may raise violations as a defense to a foreclosure action and the court may award, in addition to other damages, attorneys' fees to the defendant. Borrowers may be entitled to remedies pursuant to other causes of action. The Attorney General and Superintendent also may bring enforcement actions.

### **Restrictions on Mortgage Brokers (adds Banking Law § 590-b)**

Mortgage brokers previously had to be registered in New York<sup>23</sup> and include anyone engaged in the business of offering to solicit, process, place or negotiate mortgage loans for others. Apart from continuing education classes, however, there has been little regulation of brokers. The law imposes new duties on mortgage brokers arranging any home loans, as of September 1, 2008.

Mortgage brokers are required to act in the borrower's interest, to act with reasonable skill, care and diligence and to act in good faith and with fair dealing. Brokers will now be specifically prohibited from directly or indirectly accepting, giving or charging any undisclosed compensation, and must clearly disclose to the borrower within three days of the loan application all material information (to be specified by the Superintendent), that could affect the borrower's ability to qualify for the loan for which they applied. Also for the first time, brokers will be required to present borrowers with a range of potential appropriate loan products.

Though appraisers themselves are not regulated under the new act, lawmakers addressed the problem of inflated appraisals by placing restrictions on the appraisal process. Mortgage brokers and lenders, will now be prohibited from improperly influencing or attempting to influence the appraisal process relating to a home loan.

*Remedies:* Borrowers are entitled to actual damages, injunctive, declaratory and other equitable relief deemed appropriate by a court for violations of these duties by the broker, or for violations by a lender of the appraisal provisions. The law allows for a prevailing defendant in a foreclosure action to be awarded attorneys' fees, implying a right to raise violations as part of a foreclosure defense. Borrowers may be entitled to remedies pursuant to other causes of action. The Attorney General and the Superintendent may bring enforcement actions.

### **Regulation of Mortgage Loan Servicers**

The increase in subprime lending has been followed by an increase in negligent or abusive mortgage servicing problems. The law adds requirements that mortgage loan servicers be registered with the Superintendent, effective July 1, 2009. Mortgage loan servicers include anyone who engages in the business of servicing mortgage loans for property located in New York, including receiving payments, making payments to the owner of the loan or in the case of reverse mortgages, making payments to the borrower.

The Superintendent must set up registration procedures, and is authorized to promulgate regulations for servicers including requirements for disclosures to homeowners regarding interest rate resets; requirements regarding pay-off statements time frames for which servicers must apply payments; and requirements for servicers to file reports with the Banking

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<sup>23</sup> Registration of mortgage brokers is pursuant to Banking Law Section § 591-a.

Department. Also, the right of the Superintendent to examine the business records of licensees, and related provisions regarding business practice, are extended to cover servicers.

*Remedies:* The Banking Board may prescribe regulations, as well as, grounds for the imposition of fines or other penalty. Remedies available to the Superintendent and the Banking Board for violations by other registered entities are extended to cover violations by servicers, including an additional penalty to be paid to the people of New York.

### **Criminalization of “Residential Mortgage Fraud” (Penal Law Article §187)**

“Residential mortgage fraud” becomes a new criminal action, effective for loan originations made on or after November 1, 2008. The crime is committed by any person who prepares or provides materially false information for purposes of getting a loan, or in filing documents containing false information with a county clerk.<sup>24</sup> Borrowers applying for a residential mortgage loan who intend to live in the property are exempted from the definition, unless they act as an accessory. The law applies to transactions involving residential real property.

*Penalties:* Penalties vary based on the compensation received by the offender and range from a Class A misdemeanor to a Class B felony. Various sections of Criminal Procedure Law, Penal Law and the Banking Law are amended to include “residential mortgage fraud” within their coverage.

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<sup>24</sup> “Residential mortgage fraud” is defined as “knowingly and with intent to defraud, presents, causes to be presented, or prepares with knowledge or belief that it will be used in soliciting an application for a residential mortgage loan, or in applying for, the underwriting of, or closing of a residential mortgage loan, or in documents filed with a county clerk of any county in the state arising out of and related to the closing of a residential mortgage loan, any written statement which he or she 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.”