

# THE DAILY RECORD

LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

## Predatory lending: State enforcement efforts hobbled

BY K. WADE EATON

The U.S. Supreme Court recently relieved certain state-chartered mortgage lenders from complying with state statutes designed to provide consumers protection from practices known as predatory lending.

At issue in the case was the validity of a regulation promulgated in July 2003 by the Office of the Comptroller of the Currency (OCC), which regulates national banks.

### Federal authority under the National Bank Act

National banks are generally exempt from state laws, regulations and judicial rulings that would obstruct, impair or condition a national bank's ability to fully exercise its federally-authorized banking activities. The OCC has determined that this category includes any state consumer protection laws relating to banking activities, but not to statutory or common law claims in the areas of contracts, torts, criminal law, taxation and zoning.

The 2003 regulation purported to extend the OCC's exclusive regulatory authority over a national bank to its operating subsidiaries, even those organized and chartered under state law.

### Reaction by state bank regulators

Within days of the OCC's publication of its proposed regulation, many state bank regulators began to attack this limitation of their authority over state-chartered mortgage lenders. The New York Superintendent of Banks testified before a subcommittee of the U.S. House on behalf of the Conference of State Bank Supervisors, citing tragic examples of elderly New Yorkers who were victimized by operating subsidiaries of prominent national banks.

Superintendent Taylor described the OCC regulation as a roadway for financial providers to escape the effect of consumer protection laws and regulations. Her concern proved prescient when, within a year, Household Finance Corp. — the parent of both Household Finance Realty Corp. of New York and Beneficial Homeowner Service Corp., both of which are state-chartered subprime mort-



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gage lenders — became an operating subsidiary of HSBC, a national bank.

### In the Supreme Court

The Supreme Court case involved the Michigan Commissioner of Insurance and Financial Services, who had authority to enforce Michigan's consumer protection laws relating to mortgage lenders and predatory lending. Wachovia Bank, N.A. sued the commissioner, claiming that the OCC regulation preempted Michigan laws related to its state-chartered operating subsidiary, Wachovia Mortgage Corp.

On April 17, the court upheld Wachovia's position in *Watters v. Wachovia Bank, N.A.*, in effect removing all state-chartered operating subsidiaries of national banks from state consumer protection laws.

### The New York fallout

A major effect of *Watters* with regard to New York is its limitation of the reach of the New York's efforts to combat predatory lending.

Although Congress enacted the Home Owner's Equity Protection Act to regulate the subprime lending industry, it applied only to certain high cost loans, defined as mortgage loans that contained either an interest rate that exceeded, by more than 8 percentage points, the rate for comparable Treasury securities; or closing costs in excess of 8 percent of the loan amount.

In 2002, the New York State Legislature took action to formalize and supplement previous anti-predatory lending regulations of the Banking Department by enacting section 6-1 of the Banking Law. Section 6-1 further restricted the activities of subprime lenders and lowered the threshold for application of the law to loans for which the closing costs, including points and fees, exceeded 5 percent of the amount borrowed. The law also gave enforcement authority to the Attorney General and created a private cause of action for the victims of predatory lending.

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The relief available to the borrower now includes actual damages, statutory damages in some cases equal to all interest, points, fees and closing costs. In other cases, statutory damages are calculated as \$5,000 for each violation, or twice the amount of points, fees and closing costs.

Where a court determines that the lender engaged in an intentional violation of the statute, the entire loan agreement is considered void and the lender forfeits any right to collect principal, interest or costs. In such a case, the borrower may obtain a refund of any amounts paid previously under the loan agreement. A prevailing borrower

also may be awarded reasonable attorneys fees. A violation of the section may be employed as an affirmative defense in a foreclosure proceeding, when applicable.

Unfortunately, following the Supreme Court's decision in *Watters*, New York's legislative and administrative efforts to protect its citizens from predatory lending practices now will be limited to state-chartered mortgage lenders that are not operating subsidiaries of a national bank.

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