



## LEGAL ALERT

July 29, 2015

### **Pennsylvania Regulations Applicable to Lending Activities of Non-Profit Organizations**

Many non-profit organizations, particularly religious denominations, have formed investment or loan funds as a means to lend money to institutions and individuals that share common beliefs and social or religious goals. Often, these loan funds may provide financing at an interest rate that is lower than what can be obtained from a commercial financial institution, if such loan can be obtained at all.

Funding for these loans usually is derived from the offer and sale of unsecured debt by the loan fund and go by many names such as "deposits," "certificates" or "notes." This unsecured debt, by whatever name, is an evidence of indebtedness which is a security under the Pennsylvania Securities Act of 1972, as amended and, before they may be offered or sold in Pennsylvania, must be registered with the Pennsylvania Department of Banking and Securities (the "Department") unless an exemption from registration is available. This registration requirement was discussed extensively in our Legal Alert dated February 9, 2015.

#### **Regulation of Lending by Non-Profit Loan Funds**

These non-profit loan funds generally make mortgage and non-mortgage loans to institutions and individuals with the proceeds from the sale of unsecured debt instruments. Therefore, they need

to be aware of Pennsylvania regulations relating to non-bank lending which would apply to:

- Loan funds with a place of business in Pennsylvania that extend loans to a borrower resident in Pennsylvania or another state;
- Loan funds with a place of business in Pennsylvania that extend loans to borrowers resident in Pennsylvania or secured by real property located in Pennsylvania; and
- Loan funds which do not have a place of business in Pennsylvania that extend loans to borrowers resident in Pennsylvania or secured by real property located in Pennsylvania.

Non-bank lending in Pennsylvania is subject to the Pennsylvania Mortgage Licensing Act ("MLA"), the Loan Interest and Protection Law ("LIPL") and the Consumer Discount Company Act ("CDCA"), all of which are administered by the Department.

#### **Lending to Institutions**

As a general matter, mortgage and non-mortgage loans that are made only to institutions, such as churches and church-related organizations, will be considered to be made for commercial and business-related purposes and the loan fund making such loans will not be required to be licensed or registered with the Department under the MLA or CDCA and will not be subject to interest

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rate restrictions under the LIPL.

### **Mortgage Lending to Individuals**

However, loan funds may engage in lending to individuals such as religious loan funds making mortgage loans to clergy to purchase housing.

Although there is a *de minimis* exemption under the MLA for lenders that make up to three mortgage loans to individuals in a calendar year, loan funds using this exemption will need to be careful in terms of how much interest they charge on such mortgage loans, because if they make less than \$1,000,000 in mortgage loans in a calendar year, any such loans that are in amounts of less than the “base figure” of \$241,111 would be limited to the monthly mortgage interest rate published by the Department under the LIPL (for August 2015, 5.25%). The “base figure” under the LIPL increases annually based upon inflation.

If a loan fund would make more than three mortgage loans in a calendar year to individuals, the fund would need to register with the Department as a “bona fide nonprofit organization,” which is a “partially-exempt entity” for licensing purposes, meaning that the entity is subject to some provisions of the MLA but is not required to obtain a license in order to make mortgage loans. The registration process is accomplished by using the Nationwide Mortgage Licensing System (“NMLS”), and such registrant would need to establish and maintain a mortgage lending compliance program and potentially be examined by the Department on an annual basis.

Consistent with the definition of a bona fide nonprofit organization in the MLA, in order to qualify for the bona fide nonprofit organization partial licensing exemption, a loan fund that is lending to more than three individuals in a calendar year will need to ensure that it:

- Has the status of a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986.
- Promotes affordable housing or provides homeownership education, or similar services.
- Conducts its activities in a manner that serves public or charitable purposes.

- Receives funding and revenue and charges fees in a manner that does not incentivize it or its employees to act other than in the best interests of its clients.
- Compensates its employees in a manner that does not incentivize employees to act other than in the best interests of its clients.
- Provides or identifies for the borrower mortgage loans with terms favorable to the borrower and comparable to mortgage loans and housing assistance provided under government housing assistance programs.

### **Non-Mortgage Lending to Individuals**

If a loan fund were to make non-mortgage loans to individuals, either secured by personal property or on an unsecured basis, such loans must be at interest rates of 6% simple interest *per annum* (the “Usury Rate”) or less, or the fund would be required to be licensed by the Department under the CDCA. Non-mortgage lending to individuals is permissible in Pennsylvania without a license, provided that the interest rates and fees of the loans aggregate less than the Usury Rate.

### **Liability for Unauthorized Lending to Individuals in Pennsylvania**

An entity that engages in unauthorized lending to individuals in Pennsylvania may be subject to an administrative proceeding initiated by the Department which could result in imposition of certain sanctions and payment of a civil monetary penalty.

#### *Liability for Non-Compliance with MLA*

If a loan fund were to be deemed in violation of the MLA by virtue of engaging in mortgage lending activity with more than three individuals in a calendar year without registration as a bona fide nonprofit organization, or by failure to maintain the bona fide nonprofit organization partial exemption, the fund could be subject to an order of the Department that could include restitution to all borrowers subject to the unlicensed lending, prohibitions for each fund officer/employee involved in the unlicensed lending from working in the mortgage industry or any other industry regulated by the Department, and fines of up to \$10,000 for each violation of the MLA. Unlicensed



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nonprofit organization, or by failure to maintain the bona fide nonprofit organization partial exemption, the fund could be subject to an order of the Department that could include restitution to all borrowers subject to the unlicensed lending, prohibitions for each fund officer/employee involved in the unlicensed lending from working in the mortgage industry or any other industry regulated by the Department, and fines of up to \$10,000 for each violation of the MLA. Unlicensed mortgage loan activity also constitutes a third degree felony.

#### *Liability for Non-Compliance with the CDCA/LIPL*

Penalties for non-mortgage lending to individuals at interest rates above the Usury Rate without having a CDCA license are contained in the LIPL, and include a fund potentially being subject to an order of the Department that could include restitution to all borrowers subject to the unlicensed lending, prohibitions for each fund officer/employee involved in the unlicensed lending from working in any industry regulated by the Department, and fines of up to \$10,000 for each violation of the CDCA/LIPL. Violations for unlicensed non-mortgage lending at interest rates above the Usury Rate are misdemeanors and the Pennsylvania Office of Attorney General also has the ability to pursue civil penalties for unlicensed non-mortgage lending at interest rates above the Usury Rate.

#### **Need More Information?**

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