

# The Lending Process & The Law: Avoiding the Pitfalls



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# Numerous Major Regulatory Trends

- ◆ Fair Lending
- ◆ Predatory Lending
- ◆ Preemption/Licensing
- ◆ Marketing Restrictions
- ◆ FCRA/FACTA
- ◆ We will discuss the first two

# Fair Lending

## ◆ Three Major Issues

- ◆ HMDA Data - Loan Pricing
- ◆ Redlining and Reverse Redlining
- ◆ Automated Underwriting and “Disparate Impact”

# Fair Lending - Pricing

- ◆ New HMDA Data is bringing very high levels of scrutiny onto loan pricing practices
  - ◆ How much pricing discretion do your loan officers and brokers have?
  - ◆ How much statistical analysis of your loan pricing are you doing?
  - ◆ Do you have different pricing through different distribution channels?

# Fair Lending – Redlining and “Reverse Redlining”

- ◆ Redlining means avoiding lending in certain areas because of the race or nationality of the population, which is illegal
- ◆ “Reverse Redlining” is a relatively new theory propounded by consumer advocates to attack lenders who market higher cost loans in poor or minority areas
- ◆ Special difficulties for lenders (or even holding companies) with separate prime and subprime channels

# Fair Lending – Disparate Impact

- ◆ “Disparate Impact” means that a neutral policy has a disproportionate negative effect on minority or other “protected” people
  - ◆ Classic example: company’s policy of only hiring high school graduates – even for unskilled jobs – had the effect of excluding African-Americans from employment
- ◆ Because many key loan underwriting and pricing attributes are not equally distributed in our society, industry lawyers have been concerned about this type of lawsuit in the lending industry
- ◆ Automated underwriting systems highlight this issue as they are clearly race-neutral but their results – the loan decisions and loan pricing – are not.

# Predatory Lending

- ◆ Should you care about developments in laws and rules to inhibit “predatory lending” if you don’t make subprime loans?
- ◆ Lots of difficult technical requirements
- ◆ Two big issues:
  - ◆ Suitability
  - ◆ Assignee liability

# Predatory Lending - Suitability

- ◆ This is an extremely troubling trend in mortgage regulation
- ◆ Basic concept is to overturn a basic underlying rule relating to borrowers and lenders – that the lender is not the agent of the borrower
- ◆ If suitability requirements become law, it could be the lender's job to ensure the borrower should get a loan and that the loan he or she is getting is the right loan
- ◆ No longer will underwriting guidelines be there to protect the lender or investor against borrower default – now they will also have the dual purpose of protecting the borrower
- ◆ Look out for requirements that use phrases like “net tangible benefit” and “steering”

# Predatory Lending – Assignee Liability

- ◆ The trend in anti-predatory lending laws is to place more responsibility on purchasers of loans for the actions of the originator
- ◆ The parallel trend is to place more responsibility on the lender for the actions of the broker
- ◆ The idea is that industry knows best how to catch wrongdoing and that by requiring industry to police itself, it will allow the government to accomplish its goal of increased regulation without spending significant resources
- ◆ Ignores fact that industry response is to stop doing business with wrongdoers, not to arrest them – bad brokers or lenders can (and do) go from one lender/investor to another for years before being put out of business.

# QUESTIONS?



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