

Evaluate the Legal Risks of a Proposed Business Plan for Implementation of the Nontraditional Mortgage Guidance

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Denise L. DesRosiers

JPMorgan Chase Bank, N.A.

I. Statement of the Problem

- Implementation of the Nontraditional Mortgage Product Guidance.
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II. Is a Law Implicated?

Nontraditional Mortgage Product "Guidance"
Underwriting Guidelines.
Risk Management Policies
Consumer Protection Practices

II. Is a Law Implicated? cont...

- A. First, are there *explicit provisions* of federal or state laws and regulations that are directly implicated by the business plan? No, not directly.
- B. Second, even if no laws target the activities in question, could other general laws be construed to apply? (e.g., common law torts; UDAP laws) Yes.
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II. Is a Law Implicated? cont...

- C. Could the client be *implicated* as an accessory to a legal violation by a primary wrongdoer? (e.g., aiding and abetting) Possibly.

 - D. The fourth consideration does not depend on a violation of law to stake out a legal claim; the issue is whether the business plan could be construed to *breach any contracts* to which a client is a party.
Possibly.
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II. Is a Law Implicated? cont...

In all cases, the question is the same: Could a client end up in court because of the business plan? **Possibly.**

The first step in the risk analysis is to identify potential claims.

III. Does the Plan Violate the Law?

Not every potential claim has merit. Is there a reasonable possibility that the plan could be found to violate applicable law? Possibly, but likely not.

A. Substantive Violation

1. Is it clear that the practice violates law? (assume there are shades of gray) No.
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(A. – Substantive Violation)

2. If the operative terms are subjective, are there realistic alternative interpretations? Is there “wiggle room”? Yes. This is guidance.

a. “unconscionable”

b. “reasonable”

c. “unfair”

(A. – Substantive Violation)

3. Are there qualifiers in the law that may provide an effective defense? Yes.
 - a. “knowingly and intentionally”
 - b. “pattern and practice”
 - c. balancing test (*e.g.*, “net tangible benefit,” sham joint venture under RESPA)
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(A. – Substantive Violation)

4. Is there a causation requirement to establish a violation? (e.g., “because of,” “for,” “in exchange for”) Yes.

(A. – Substantive Violation)

5. Is there a “safe harbor” for which one might qualify? **No.**

 6. Could the probability of an unfavorable outcome be materially reduced by restructuring the business plan in ways that do not frustrate business objectives? **THIS IS WHERE A LAWYER CAN ADD THE MOST VALUE TO A CLIENT! Yes.**
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III. Does the Plan Violate the Law?

cont...

The filing of a civil claim in court triggers several procedural protections that may affect the risk profile of a business plan.

B. Procedural Context

1. Whether it is reasonably likely that a court will grant a defendant's motion to dismiss is one inquiry. Assuming the facts as pled are true, does the law compel the conclusion?

No.

(B. – Procedural Context)

2. The length of the statute of limitations is another important procedural issue. Look to the various statutes that could come into play.
 3. Individual claims pose substantially less risk than a putative class action. Claims may occur individually and as a class actions.
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(B. – Procedural Context)

4. Fear of discovery may impact decision.
Actions are visible to unrelated third parties.
 5. Does the answer differ based on whether the plaintiff challenges the practice under a specific substantive law or a more general UDAP or common law claim? No. The more likely claim will be under a more general UDAP or common law claim.
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IV. Is a claim likely to be asserted?

- A. Is there a private right of action? If so, are there economic incentives to attract plaintiffs' attorneys to try? (*e.g.*, attorneys fees, enhanced damages) No. But look to other statutes.

 - B. What government agencies have specific enforcement authority with respect to the law in question? As to Guidance, Federal and state agencies. As to UDAP claims, FTC and state agencies.
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IV. Is a claim likely to be asserted? cont.

- C. Is the practice in question already the subject of other private lawsuits or government enforcement actions? *Yes*. If so, what is the status of such lawsuits and claims? *Emerging*.

 - D. Is the practice in question generally known in the market place or otherwise visible to potential plaintiffs? *Yes*.
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IV. Is a claim likely to be asserted? cont.

- E. Does the practice look “ugly”? Who has the better rhetorical sound bite? *Possibly.*
 - F. Is the practice likely to lead to “tattletale” complaints by competitors? *Yes.*
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IV. Is a claim likely to be asserted? cont.

- G. How likely is it that an avalanche of claims will follow an individual lawsuit? **Unknown.**
 - H. Are there other deep-pocket defendants?
Likely Yes.
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V. What are the penalties?

- A. Are the company and the participating officers and employees subject to criminal sanctions? *Not likely.*
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V. What are the penalties?

- B. What are the monetary penalties? Potentially. Borrower claims, defaults, investor claims.
1. Are the affected contracts still enforceable?
 2. How hard is it to calculate actual damages, and could such damages be substantial?
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(B. - What are the monetary penalties?)

3. Does the law provide for statutory, punitive, or enhanced damages, and, if so, could such damages be substantial?
4. Is there a statutory ceiling or cap on the amount of damages that can be awarded? Does it depend on how claim is asserted? (*e.g.*, as a class action)

□ Look to UDAP claims statutes.

V. What are the penalties?

- C. Would the resulting liability from an unfavorable decision be material to the financial condition of the company? Potentially.
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VI. Are undesired spillover consequences likely from the mere filing of a claim?

- A. Would such a claim impair the Company's reputation with customers? *Yes.*

 - B. Would it increase the likelihood that other claims would be filed by additional private plaintiffs or one or more government agencies? *Yes.*
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VI. Are undesired spillover consequences likely from the mere filing of a claim?

- C. Would it impact the Company's government permits, licenses or approvals? *Yes.*

 - D. Could it cause a breach of covenants or create cross defaults under agreements with third parties? (*e.g.*, credit agreements) *Yes.*
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VI. Are undesired spillover consequences likely from the mere filing of a claim?
cont...

- E. Could it impair the value or the rating of the Company's debt or equity securities in the marketplace? *Yes.*
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VI. Are undesired spillover consequences likely from the mere filing of a claim?

- F. Could it impair the ability of the Company to conduct business on a going forward basis with investors, insurers, rating agencies, or lenders? *Yes.*
1. Could the CEO sign the SOX certificate? Could the applicable division heads sign any internally required back-up certificates? *Probably.*
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(F. – impair ability of company to conduct business...)

2. Are there any changes that should be made in the applicable securities disclosures? No.
 - a. Are there additional risk factors that should be disclosed in registration statements?
 - b. Are there factual assertions in the registration statements that are inconsistent with the circumstances surrounding the additional risk?
 - c. Must the disclosures be revised in the “Management Discussion and Analysis”?
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VII. Does the practice violate the company's code of ethics?

Ethics code likely states that employees must comply with all applicable law and regulation.

VIII. Is the right person making the ultimate risk decision?

Level may be dictated by degree of financial and reputational risk.

Nontraditional Mortgage Product Guidance

Risk as real under guidance as under law or regulation. Especially with highly prescriptive guidance.

Risk analysis involving consumer protection issues are particularly challenging. Financial and reputational.

Significant Risk if NTMP Guidance is not properly implemented.
