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The Challenge of Complying with State and Local Laws and Regulations

by

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- **Continued exportation of predatory lending restrictions and prohibitions into non-predatory requirements**
 - Predatory lending restrictions that apply irrespective of financial triggers (e.g., Nevada AB 440; Minnesota HF 1004/SF 988).
 - Predatory lending restrictions that apply to an intermediary class of loans (e.g., Maine HP 1301/LD 1869; North Carolina HB 1817 (S.L. 2007-352)).
 - Tangible net benefit requirements for non-high cost home loans (currently the following 13 states regulate such practices: Arkansas, Colorado, Illinois, Maine, Massachusetts, Minnesota, New Mexico, North Carolina, Ohio, Rhode Island, South Carolina, Virginia and West Virginia).

- **Underwriting guidelines that obligate lenders to determine a borrower's ability to repay**
 - Final Interagency Guidance on Nontraditional Mortgage Product Risks and Statement on Subprime Mortgage Lending apply to insured depository institutions and their operating subsidiaries.
 - Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) issued substantially parallel guidance for nondepository lenders "to promote consistent regulation of the mortgage market."

- States have enacted statutes regulating the borrower's ability to repay non-high cost residential mortgage loans in Colorado, Maine, Minnesota, Nevada, North Carolina and Ohio.
- These statutes impose heightened regulatory scrutiny for stated or low doc loans.
- Non-amortizing or negative amortization loans are also under heightened scrutiny (e.g., Minnesota bans products with negative amortization although such restriction arguably is preempted by the Alternative Mortgage Transactions Parity Act; Maine's HP 1301/LD 1869 contains a similar prohibition but only with regard to high cost home loans)

➤ **Increased regulation of mortgage broker practices**

- Loan originator licensing, continuing education practices and criminal background checks.
- CSBS and AARMR are working to develop a national mortgage license system to ensure that companies and individuals that have engaged in fraudulent activity in the past cannot relocate to a new state and continue that activity.
- Statutory duty of care of mortgage brokers (e.g., Colorado and Ohio impose a duty of good faith and fair dealing on all communications and transactions; Minnesota brokers will be considered to have created an agency relationship with the borrower in all cases).

➤ **State Attorneys General are working to seek to use state deceptive trade practice laws and other laws to attack lending practices**

- States are giving AGs enforcement authority over abusive lending practices (e.g. Ohio SB 185; North Carolina HB 1817 grants the Banking Commissioner and the Attorney General enforcement authority specific to the new rate spread home loan statute).
- AGs are using their authority. In March 2007, Ohio Attorney General Marc Dann and the Ohio Department of Commerce entered an injunction against New Century and certain of its affiliates. The complaint arose out of New Century's inability to fund mortgage loans and its alleged violations of the Consumer Sales Practices Act and other mortgage statutes.
- Massachusetts Attorney General Martha Coakley filed a lawsuit on October 4, 2007 against Fremont Investment and Loan and Fremont General Corporation (collectively, "Fremont") alleging that Fremont's origination and servicing practices violated Massachusetts Chapter 93A, the

Commonwealth's Consumer Protection statute. The complaint alleges a number of unfair and deceptive practices including originating 2/28, 3/27 and other residential mortgage loan products without regard to the borrower's ability to repay, excessive risk layers such as 100% financing, piggyback seconds, prepayment penalties and reduced document underwriting. The complaint also alleges that Fremont failed to exercise oversight over its broker network and failed to disclose broker compensation.

The complaint also raises a novel legal argument, which if accepted by the court or adopted by legislators or regulators in other states, could have far-reaching consequences. The complaint alleges that "Fremont made de facto short-term high-cost loans disguised as ARM loans in violation of the [Commonwealth's] Predatory Home Loan Practices Act [(the "Predatory Act").]" The argument is that while these 2/28 or 3/27 ARMs ostensibly were paid over a long term (30-50 years), they were in fact designed and marketed as short-term loans with massive balloon payments. If these loans were structured as short-term balloon loans, the points and fees would have exceeded the financial thresholds under the Predatory Act. The complaint alleges that Fremont disguised its short term high cost loans by separating them into a short-term introductory period with a teaser rate and a longer term adjustable rate period. According to the Attorney General, this practice violates the prohibition against dividing any loan transaction into separate parts in order to avoid the application of the Predatory Act.

➤ **Greater emphasis on servicing-related practices**

- David Bleicken, President of AARMR, announced that this is an area of attention for state regulators.
- North Carolina enacted the Mortgage Debt Collection and Servicing Act in HB 1374, effective April 1, 2008.
- States are encouraging workouts/modifications:
 - On Sept. 5, 2007, Governor Arnold Schwarzenegger issued Release No. 61-FS encouraging lenders and servicers of loans under the California Finance Lenders Law and Residential Mortgage Lending Act to identify borrowers who are potentially in distress early, and to work with them as appropriate consistent with the following additional statements dated Sept. 4, 2007: (i) the Interagency Statement on Loss Strategies for Servicers of Residential Mortgages and (ii) the Joint Release published by the FDIC, CSBS and AARMR suggesting servicers avoid debt-to-income ratios above 50 percent for modified obligations.

- Also, in Sept. 2007, AGs from 10 states announced the formation of a task force to encourage loan servicers to provide workouts (AZ, CA, CO, IL, IA, MA, NY, NC, OH and TX).

➤ **Strategies to address foreclosures**

- Task forces
- Slowing of foreclosure process
- Counseling/foreclosure prevention lines
- Encouraging workouts/modifications

➤ **Lending to undocumented aliens**