

State Anti-Predatory Lending Developments

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Fundamental Questions

- What are the characteristics of state predatory lending laws?
- Where did they come from?
- How have they evolved over time?
- How will they likely change in the future?

State Laws Predicated on HOEPA

- HOEPA (Home Ownership Equity Protection Act) enacted in 1994 as an amendment to TILA
- Applicability of law based on points and fees and APR thresholds
- Less sophisticated consumers need greater protection
- Does not apply to purchase money or open-end loans
- Imposes substantive restrictions
- Provides assignee liability
- RESULT: Regulate only a small percentage of loans made

State Mini-HOEPA Laws Applicable to High Cost Loans

- Reduce points and fees and APR thresholds
- Extend scope to capture loans excluded by HOEPA (such as purchase money and open-end loans)
- Expand substantive prohibitions, including no:
 - Balloon payments
 - Negative amortization
 - Loan flipping
 - Prepayment penalties
- Expand assignee liability (though generally quantifiable)
- Expand remedies
- RESULT: Few high cost loans are made in jurisdictions with such laws

Why Few HOEPA Loans are Made

- Assignee Liability
 - Imposes unquantifiable risk to purchasers of loans
 - Allows for substantive claims for violation of any federal, state or local law
 - Right of rescission
- Enhanced Damages

Some Examples of state Mini-HOEPA Laws – North Carolina, adopted July 1999

- Considered a model followed by other states
 - Created new limits on High Cost Loans:
 - High Cost Loan = "Home Loan" that crosses either APR Trigger, Points and Fees Trigger or Prepayment Fee trigger
 - APR trigger same as HOEPA
 - Points and fees trigger 3 percentage points less than HOEPA for loans with a principal amount of \$20,000 or more
 - Prepayment fees permitted under the loan documents more than 30 months after the loan closing or which exceed, in the aggregate, more than two percent of the amount prepaid also will make loan high cost
 - High Cost Loans subject to an expansive list of prohibited practices
- Created new limits on "Home Loans" including
 - Restrictions on prepayment fees
 - No flipping
 - No financing single premium credit insurance
- No express assignee liability but subject to penalties under usury law and UDAP statute

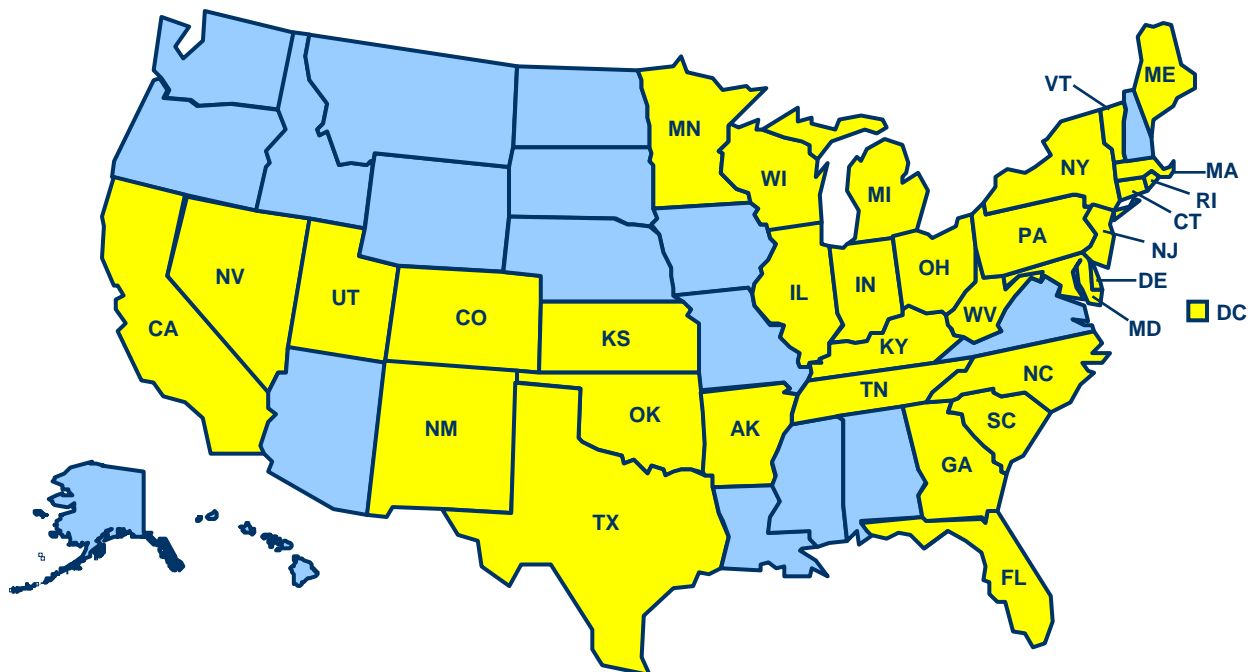
Another Notable Example - Georgia

- The original Georgia Fair Lending Act (GFLA) was effective October 2, 2002 was more onerous than other state initiatives because of:
 - the scope of assignee liability (with uncapped damages)
 - the characterization of routine servicing practices as "predatory," and the application of the law specifically to servicers in certain circumstances
 - the fact that an originator would be unable to determine at the time of loan application that a loan is subject to the Act, and
 - the fact that prime loans may inadvertently be subject to the Act's provisions because of the low threshold for and broad definition of the "points and fees" triggering test for "covered home loans"

Georgia Fair Lending Act – Amended

- Rating agencies opted "not to rate transactions with uncapped assignee liability as detailed in the GFLA"
- Because of concerns that mortgages from Georgia could not re-sold on the secondary market, which would limit credit availability to Georgia residents, legislature modified the assignee liability section
- March 7, 2003 amended GFLA became law, but not retroactively
- Under amended law, assignee liability is capped at "the sum of all remaining indebtedness of the borrower under such loan and reasonable attorneys' fees"

Jurisdictions with mini-HOEPA laws



Also note that some local regulators have imposed predatory lending ordinances in their city or county, some which have been invalidated, such as those in Montgomery County, MD and Toledo, OH.

A Shift in Anti-Predatory Lending Policy

- Housing bubble burst
- Expanded applicability of traditional anti-predatory lending restrictions (e.g. Nevada, Minnesota)
- The current trend is to focus less on financial thresholds, and to focus more on anti-predatory loan characteristics, which includes how lenders underwrite and market loans

Regulating Underwriting Practices

- Lenders required to assess the borrower's ability to repay based on fully-indexed, fully amortized payment non-high cost residential mortgage loans in 13 jurisdictions
 - e.g. CA, CO, IL, ME, MD, MA, MI, MN, MO, NV, NC, OH, WV
- Effective to ban stated income loans in certain states
 - Implicit restriction on certain non-amortizing loans
- Refinanced loans must have a tangible, net benefit to the borrower in 14 jurisdictions
 - e.g. AK, AR, CO, IL, ME, MA, MN, NM, NC, OH, RI, SC, VA, WV

Nontraditional Guidance/Subprime Statement Main Principles

Nontraditional Guidance (applies to insured depository institutions and their op subs):

- Strongly cautions lenders to use stringent underwriting criteria
- Provides normative instructions for loan terms that lenders are encouraged to avoid and risk management practices that lenders are encouraged to adopt
- Borrower should receive clear and balanced information

Subprime Statement (applies to insured depository institutions and their op subs):

- Assess ability to repay
 - Verify and document borrower's income, assets, and liabilities
 - Establish clear policies governing the use of risk-layering features
 - DTI analysis should include PITI as a percentage of monthly income
 - Borrower should receive clear and balanced information
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- CSBS/AARMR issued substantially parallel guidance “to promote consistent regulation of the mortgage market.”
 - At least thirty-four states have “adopted” the CSBS/AARMR’s Nontraditional Guidance
 - At least twenty-seven states have “adopted” or are considering the adoption of the CSBS/AARMR Subprime Statement

New “Yellow-Light” Provisions

- Act to Protect Maine Homeowners from Predatory Lending
 - Creditor cannot extend a “subprime mortgage loan” unless a reasonable creditor would believe the borrower could repay the loan (based on factors set forth in the statute)
 - “Subprime mortgage loan” is:
 - Nontraditional mortgage as defined in the guidance,
 - A rate spread home loan reportable under HMDA, or
 - A high rate-high fee mortgage
 - Damages for a violation include actual, statutory, and punitive (if violation is malicious or reckless)
- North Carolina amendments regulate a new loan category, Rate Spread Home Loan, that are subject to an ability to repay requirement and a prohibition on charging or collecting prepayment penalties

Restrictions on Prepayment Fees

- More than 2/3^{rds} of states regulate/restrict prepayment fees
- Maryland legislature enacted new bill, 2008 MD HB 363, effective June 1, 2008 which prohibits any prepayment penalty for the prepayment of a mortgage loan in whole or in part

Greater regulation of mortgage brokers

- Loan originator licensing, continuing education practices and criminal background checks
- CSBS/AARMR developed a national mortgage license system to ensure companies/individuals that have engaged in fraudulent activity in the past can't relocate to a new state and continue that activity
- Statutory duty of care (e.g. Colorado, Ohio, Minnesota)
- Restrictions on YSP's (e.g. Massachusetts, Colorado)

Anti-steering restrictions

- Massachusetts recently instituted regulations that ban steering
 - AG regulations prohibit mortgage brokers from arranging or processing loans that are not in the borrower's interest, and prohibit brokers from brokering loans if the broker's financial interest conflicts with the borrower's interest
 - Also prohibit mortgage lenders from either steering borrowers to loan products that are more costly than others for which the borrower qualifies or discriminating between similarly qualified borrowers
- Several other states, including Minnesota, North Carolina and Ohio have addressed steering through anti-predatory lending laws and broker regulations

Consumer Counseling – Cook County

- In 2005, Illinois established predatory lending database for residential mortgages in ten zip codes within Cook County.
 - Law took effect on Sept. 1, 2006, but was suspended in Jan. 2007 due to claims that it was discriminatory and limited loan availability
- Effective July 1, 2008, “pilot program” status is removed; program will be permanent.
- Program now requires specific database information on all loans in Cook County (not just certain zip codes). Pre-loan counseling is required if a first-time homebuyer or refinancing a primary residence and the mortgage loan meets at least one of the following criteria:
 1. it permits interest only payments;
 2. it may result in negative amortization;
 3. the total points and fees payable at or before closing exceed 5%;
 4. it includes a prepayment penalty; or
 5. it is an ARM loan

Counseling no longer required based on FICO score
- Certificate of compliance required to record mortgage
- In foreclosure action, notice of lis pendens is of no force and effect unless certificate of service simultaneously recorded affirming copy of lis pendens was filed with the Department

Consumer Counseling – Massachusetts

- Mortgagees in Massachusetts are prohibited from making a subprime ARM loan to a first-time home loan borrower unless the mortgagor affirmatively opts in writing for the ARM subprime loan and receives certification from a counselor
- For a subprime loan made in violation of this requirement, the variable/adjustable rate terms of the loan will not be enforceable and the mortgagee will only be entitled to collect an interest rate equal to the lesser of the original interest rate, including any discounted rate, or the current adjusted interest rate throughout the remaining term of the loan

State AGs are extremely active

- States are giving AGs enforcement authority over abusive lending practices (e.g. Ohio; NC). Will likely have to deal with Aspiring Governors
- Massachusetts AG regulations
 - now apply to all residential mortgage loan transactions, but not reverse mortgages or open-end lines of credit; apply to licensed brokers and all lenders
 - impose an ability to repay requirement; restrict stated income/limited documented loans; prohibits steering; regulates discretionary pricing; and requires new disclosures
- Focus on protecting investors and consumers from doing harm to themselves

The Fremont Example

- On February 25, 2008, a Massachusetts court issued a preliminary injunction against Fremont to block enforcement of “presumptively unfair subprime loans”
- Court said “Fremont got them into this mess and now must take reasonable steps to get them out”
- The Court ordered Fremont to provide the AG with at least a 30-day notice of all foreclosures it intends to initiate and must allow the AG an opportunity to object. If Fremont has made an owner-occupied loan that is “presumptively unfair,” the AG has 45 days to object
- A mortgage loan is “presumptively unfair” if it is secured by the borrower's principal dwelling and has the following characteristics: (a) ARM with introductory period of ≤ 3 years; (b) introductory rate is at least 3% lower than the full-indexed rate; (c) DTI $> 50\%$ when measuring the debt due under the fully-indexed rate; and (d) 100% financing or loan has a substantial prepayment penalty or penalty that lasts beyond the introductory period

State Policy Response

- Prevent problem loans from being made
- Help borrowers stay in their homes
- Among other initiatives, states are extending foreclosure timeline (or considering moratoriums):
 - Effective May 1, 2008, all mortgages on Massachusetts owner-occupied, residential real estate will be subject to a 90-day cure period of a payment default once every five years
 - On April 3rd 2008, Maryland modified its foreclosure process by prohibiting an action to foreclose a mortgage or deed of trust on residential property until the later of 90 days after default or 45 days after sending a Notice of Intent to Foreclose
 - Regulators said that "[b]ecause of the emergency nature of this legislation, no foreclosure actions will be ripe for filing for at least 45 days from the law's effective date since lenders will not have had the opportunity (and were not required) to send the requisite 45-day Notice of Intent to foreclosure prior to the effective date of this law."

Predatory Lending Reform Tied Into Foreclosure Relief

- Example Governors Program Bill #44 in New York
 - Bill seeks to avert the “mortgage foreclosure crisis” in the state by:
 - Adding process requirement for those borrowers at risk of losing their homes, such as requiring notice 60 days prior to legal action; and
 - New obligations on mortgage servicers who seek to enforce their legal rights as holders of the mortgage in case of default
 - Bill seeks to expand existing protections and establish new and additional standards governing lending practices by:
 - expanding the definition of “home loan” to loans of up to \$750,000 (increased from \$417,000),
 - creating a new class of “yellow light” loans that will be subject to the restrictions under the current high cost law, and
 - establishing an ability to repay standard, and a broker duty of care standard for all home loan

Cities Fighting Back Against Predatory Lending

- Jan, 2008. City of Baltimore sues Wells Fargo alleging that it engaged in "reverse redlining" which is the practice of "targeting residents in certain geographical areas for credit on unfair terms due to the racial or ethnic composition of the area." According to the complaint, such practice resulted in a disproportional high foreclosure rate on loans to African Americans in Baltimore which caused injuries to Baltimore, such declining property values, and an increase in the number of abandoned homes.
- Jan, 2008. City of Cleveland sues 21 lenders in states court alleging these lenders engaged in a public nuisance by originating loans to unqualified borrowers "under circumstances that made the resulting spike in foreclosures a foreseeable and inevitable result." The City alleges its suffered damages including the cost of maintaining foreclosed properties and decreased tax revenues.
- March, 2008. City of Boston passed and Mayor signed An Ordinance Regulating the Maintenance of Vacant, Foreclosing Residential Properties that requires:
 - All property owners must properly maintain vacant and/or foreclosing properties;
 - Property owners must certify the property was inspected and pay an annual registration fee per property;
 - The owner or local contact must monthly inspect and maintain the property during vacancy.
 - Failure to comply will result in administrative fines of \$300 for failing to register or identifying the local individual or maintaining the property (assessed each week the property is not maintained).