



**Nonprime Loan Level Due Diligence**  
*Legal Considerations in Portfolio  
and Company Acquisitions*

- Portfolio Acquisitions
- Company Acquisitions

## Principal Legal Issues:

- Assignee Liability/Vicarious Liability
- Preemption
- Chain of Assignments
- Predatory Lending
- Servicing Information

- General rule for Mortgage Loans—the purchaser is a “Holder in Due Course,” meaning that the purchaser cannot be sued for the creditor’s acts and practices unless they are “apparent on the face” of the purchased note
- One significant type of violation that is an exception is a usury violation, because the purchaser should be able to look at the note rate and know that the note violates the law— i.e., it is “apparent on the face”
  - Interesting question: What about usury violations that are not apparent on the face?

- General “Holder in Due Course” rule is reversed for certain loans
  - Federal HOEPA loans
  - State “high cost” loans
  - HOEPA and most state high cost laws create a limited due diligence exception for purchasers

- Two principal due diligence standards for the liability exception:
  - Showing that a reasonable person exercising ordinary due diligence could not determine that a loan is subject to the special assignee liability provisions (i.e., is a HOEPA/predatory/high cost home loan)
    - HOEPA and Arkansas, DC, Colorado, Florida, Georgia, Ohio, Oklahoma, and Tennessee
  - Showing the following: (1) due diligence to prevent the purchase of predatory/high cost home loans; (2) policies expressly prohibiting the purchase of predatory/high cost home loans; and (3) contracts with sellers providing a warranty that the assignor will not assign high risk home loans to the assignee
    - Illinois, Indiana, Maine, Massachusetts, New Jersey, New Mexico, and Rhode Island
- No due diligence exception: Connecticut, Kentucky, and New York

- Wildcards
  - Enforcement agencies sometimes jump over entity that committed violation to deeper-pocketed entity they consider “responsible”
    - FTC
      - Mercantile Mortgage – lender responsible for broker actions
      - DirecTV – Satellite TV service provider responsible for “do not call” violations of third party telemarketing providers
    - Massachusetts Attorney General position in Fremont case
    - West Virginia Attorney General debt collection settlements
  - “Aiding and Abetting” or “Close Connectedness”

- Greater purchaser scrutiny of seller preemption claims
- Preemption – different types of preemption appear to attract different levels of scrutiny
  - No one seems to question DIDMCA elimination of state usury laws for first mortgages
  - Expect continued litigation on edges of entity-based preemption
    - 9<sup>th</sup> Circuit victory by E\*Trade Bank against state unfair and deceptive acts and practices claims
    - 2<sup>nd</sup> Circuit victory by national banks against New York Attorney General on HMDA data investigation

- Notorious Ohio decision slowing foreclosure because Wall Street purchaser did initiate foreclosure with proof of all assignments in hand.
- Numerous challenges against loans still held nominally by MERS

- Increasing focus on whether loans were “predatory” – whatever that means – in addition to technical compliance with consumer protection laws and disclosures
  - Tangible benefit
  - Ability to pay
  - Need for transfer of additional information to substantiate servicing fees

- Focus on servicing platforms and assets
- Operational capabilities
- Regulatory show-stoppers

- Regulatory issues
  - Federal or state banking agencies (principal examining regulators)
  - State Attorney Generals and other enforcement agencies
    - Multi-State Attorney General Task Force focused on servicing

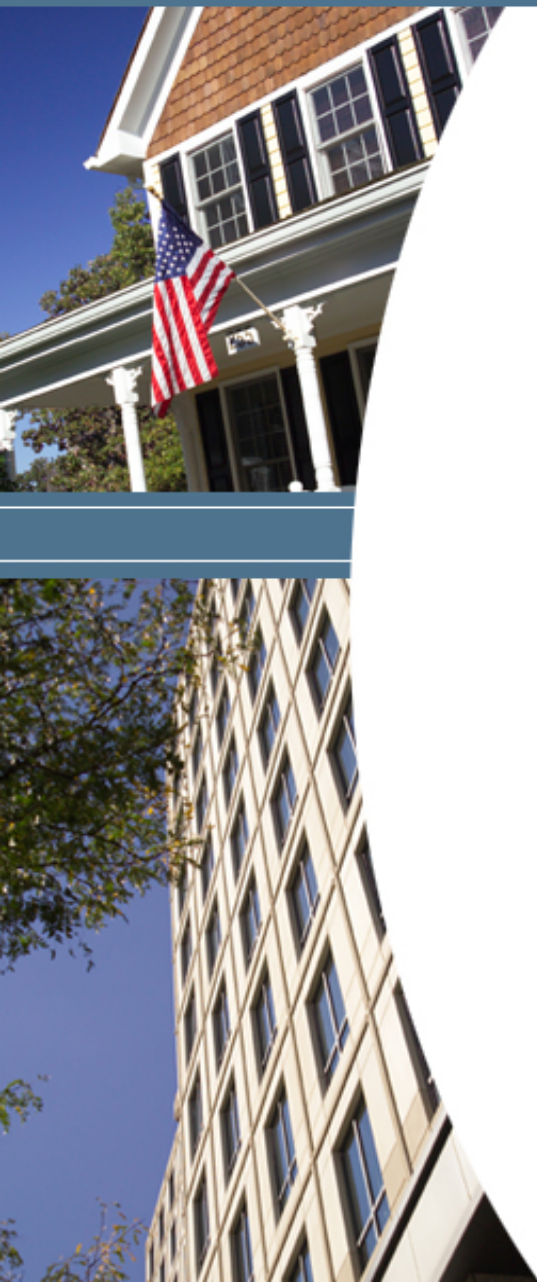
- Political and regulator pressure to modify loans
  - Representative Waters (D-CA) proposal to require immediate access to decision-maker



- Investor pressure to comply with servicing agreements and maximize returns on pools
- Operational costs of excessive loss mitigation strategies encouraged by regulators and politicians



- Data integrity
- Ancillary fee income
- Outsourcing and related cost savings
- Off-shoring
- Default triggers allowing servicer termination



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