

Regulatory Update: State Issues

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What are some of the trends that we are seeing in the States?

- Origination Trends
- Servicing Trends
- Laws enacted today will lay the playing field for the next decade

Origination Trends

- Licensing
- Increased regulation of mortgage broker practices
- Continued exportation of predatory lending restrictions into non-predatory requirements
- Regulating underwriting practices
- More requirements
- State Attorneys General are working to use state UDAP laws and other laws to attack lending practices

Servicing Trends

- Servicing practices subject to higher regulation
- New reporting obligations for servicers
- Laws being contemplated that would extend the timeline for foreclosure
- Cities are fighting back

Licensing

- CSBS and AARMR have developed a national mortgage license system to ensure that people who previously engaged in fraudulent activity cannot relocate and continue that activity.
- A few states (Florida and Nebraska) have taken the position that re-licensing is required when a licensee changes its officer and/or director (although the law does not necessarily support the regulators' views).
- With increased company bankruptcies, record retention issues are becoming more significant. Expect states to look at record retention agreements with licensees more closely.

Increased regulation of mortgage broker practices

- Statutory duty of care (e.g. Colorado and Ohio impose duty of good faith and fair dealing on all communications; Minnesota brokers are considered agents of the borrower in all cases).
- North Carolina expands list of duties to, among others, a duty to
 - Make reasonable efforts to secure a loan that is reasonably advantageous to the borrower;
 - Disclose material information, including the mortgage broker's expected total compensation in connection with each potential loan option;
 - Notify each lender of the particulars of the other loans secured by the same property being made contemporaneously, if known; and
 - Ensure that any services offered to an applicant are available to all similarly situated applicants on an equal basis.

Continued exportation of predatory lending restrictions into non-predatory requirements

- Predatory Lending restrictions that apply irrespective of financial triggers
 - Nevada amendments extend application of the defined unfair lending practices to all residential mortgage loans secured by Nevada property; not just HOEPA loans.
 - New Minnesota law subjects originators and servicers to ability to repay and net tangible benefit requirements, disclosure requirement of T&I, and prohibit negatively amortizing residential mortgage loans, other than a reverse mortgage loan. No financial thresholds are imposed.
- Predatory lending restrictions that apply to an intermediary class of loans
 - New Maine law adds two new loan categories to its anti-predatory lending law, Residential Mortgage Loan and Subprime Mortgage Loan.
 - New North Carolina law adds 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.

Regulating Underwriting Practices

- Nontraditional Guidance and Subprime Statement apply to insured depository institutions and their operating subsidiaries.
- CSBS and the 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 10 jurisdictions.
- States have enacted statutes requiring a borrower’s tangible net benefit in 14 jurisdictions.
- Non-amortizing or neg. am loans are also under heightened scrutiny (e.g., Minnesota).

More Requirements

- **DC**
 - New disclosure requirement for non-conventional mortgage loan (any loan that is not a fixed-rate mortgage loan with an amortization period of 30 years or less) within 3 days of application.
 - A violation of this provision is an unfair trade practice. The statute allows a private right of action for violations, including punitive and treble damages.
- **Massachusetts**
 - Mortgagees 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.
- **North Carolina**
 - Brokers are prohibited from closing ARM loans that qualify as Rate Spread Home Loans without disclosing to the borrower the terms and costs of a fixed rate loan at the lowest APR for which the borrower qualifies.
 - A violation of this provision (that is not properly cured) is usury. Brokers are joint and severally liable for this violation (but lenders are not liable for brokers' violations).

State AGs are working to use state UDAP and other laws to attack lending practices

- States are giving AGs enforcement authority over abusive lending practices (e.g. Ohio; NC).
- 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.
- Massachusetts AG filed a lawsuit on Oct. 4, 2007 against Fremont alleging that its origination and servicing practices violated Chapter 93A. The complaint alleges unfair and deceptive practices including originating 2/28, 3/27 and other 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.

Fremont

- On February 25, 2008, a preliminary injunction was issued in the case.
- Although the loans Fremont made were not per se illegal under MA or federal law, the court nonetheless found that it is unfair for a lender to issue a home mortgage loan that the lender reasonably expects will fall into default once the introductory period ends unless the FMV of the home has increased.
- 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.

Servicing Trends

- Servicing practices subject to higher regulation
- New reporting obligations for servicers
- Laws being contemplated that would extend the timeline for foreclosure
- Cities are fighting back

Servicing practices subject to higher regulation

- **North Carolina Mortgage Debt Collect and Servicing Act (effective April 1, 2008)**
The Act applies to “home loans” and provides that:
 - Any fee incurred by a servicer must be (i) assessed within 45 days of the date it was incurred and (ii) explained in a statement at least 30 days after assessing the fees.
 - All payments to the servicer must be credited within one business day of receipt. For loans on the scheduled method of accounting, any regularly scheduled payment made prior to the scheduled due date shall be credited no later than the due date.
 - All fees charged by a servicer “must be otherwise permitted under applicable law and the contracts between the parties.”
 - New requirements exist for responding to borrower requests for information and disputes.
 - An action for a violation of this Act can be brought by the Banking Commissioner, the AG or any party to a home loan. Remedies include actual damages, including reasonable attorneys’ fees, as well as equitable remedies or other remedies of law. There are also cure provisions if a borrower attempts to bring a civil action against a servicer.

New Reporting Obligations for Servicers

Maryland

- Maryland Governor announced emergency regulations that will require servicers licensed under Maryland law to provide loan-level information on their servicing portfolios to DLLR on a monthly basis, beginning March 20, 2008.
- Report must include information including loss mitigation activities, adjustable rate loan data, number of loans serviced by licensee in foreclosure, etc.

Laws being contemplated that would extend timeline for foreclosure

- No shortage of proposed initiatives that would extend the timeline for foreclosure by either imposing a moratorium on foreclosures or providing the borrower with an extended right to cure.
- To date, very few moratoriums have been enacted, but a few states have recently enacted a right to cure that would extend the timeframe to foreclosure.
- For example, Massachusetts 90-day right to cure a default:
 - 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.
 - New law will prohibit the charging of any fees or penalties “attributable to the exercise of a right to cure” within the 90 day period other than per diem interest and late charges permitted by law.

Cities are fighting back

- 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 subprime 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).