

# A Brief Lesson in What Drives Residential Mortgage Litigation

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# Overview

- People sue because they are frustrated.
- Residential mortgage is closely regulated by federal and state governments.
- It's the lawyers – not the clients -- who figure out the technical reasons in the complaint.
- Fee shifting statutes means the cases are often all about the lawyer's fees, not the borrower.
- Common sense, training and a strong procedures manual will avoid most problems.

# Who Is Looking Over Your Shoulder

- State Department of Banking
- HUD, DOJ, federal bank examiners
- State Attorney General's offices
- Consumer lawyers
- Class action lawyers
- Title companies
- Wholesale loan purchasers
- Fannie and Freddie

# 1. Early Payment Default

- Borrower's failure to make first payment is red flag that other problems may exist
- EPD means heightened scrutiny by secondary market purchasers
- Telltale fraud signal

# 1. Early Payment Default, cont.

- Avoid EPD through proper underwriting and loan processing.
- Due diligence in the selection of brokers, closers and other settlement service providers also helps.
- Title insurance provides protection from some fraud problems.

## 2. Rescission Notices in Refinance Transactions

- Federal Truth in Lending Act requires that “each” person with an interest in the mortgaged property receive **TWO COPIES** of the Rescission Notice.
- Notices must be filled in with proper dates (three **business** days).
- Stupidest, most abused law in all of mortgage land (a personal view).

## 2. Rescission Notices in Refinance Transactions, cont.

- Two co-borrowers (husband and wife) must get **FOUR COPIES** of Notice.
- If there's one borrower, but two names on the mortgage, both must get two copies of the Notice.
- TILA allows them to rescind the mortgage for up to three years.
- Claim can be brought against assignees of original lender.

## 2. Rescission Notices in Refinance Transactions, cont.

- Problem is easily avoided by knowing the rule and providing clear, explicit closing instructions and documents.
- Helps to get affidavit from closing agent as part of closing package.

### 3. Exotic Loan Products

- Borrowers focus on monthly payment amount.
- Unsophisticated borrowers may not understand alternative mortgage credit terms like balloon, ARMs or “interest only” loans.
- When payments go up or balloon comes due, borrowers say, “Nobody told me!” They go to a lawyer.
- New products require strong disclosures and quality customer relations.

## 4. Bad Appraisals

- Over-appraised properties mean under-secured lenders.
- Claims against originating lender by secondary market purchaser.
- Fannie and Freddy review appraisals when loans go to foreclosure – may lead to repurchase or indemnity request against loan seller.

## 4. Bad Appraisals, cont.

- Believe it or not, borrower lawsuits claiming “You lent me too much money!”
- “Predatory Lending” theory – lending based on obtaining maximum amount that borrower can possibly pay.

## 5. “Referral” Fees

- Federal Real Estate Settlement Procedures Act (RESPA).
- Illegal under RESPA to pay or receive a fee, kickback or anything of value for referral of business.
- It’s a crime – fines, imprisonment.
- Private lawsuit to get three times the charge.
- Some courts hold that markup of third party service is RESPA violation.

## 6. Forgery

- Some give in to temptation to forge a signature on that additional disclosure.
- Use a notary correctly.
- Forgery makes bad situation, where there is a missing signature on a document, and makes it worse.
- Some mistakes can be fixed by going back to the borrowers and getting them to sign new disclosures or by modest adjustments to the loan.

## 7. Bogus Rate Locks

- Verbal promises of “rate lock” lead to borrower disappointment, when lender fails to honor unwritten “commitment.”
- Borrowers not informed of lock expiration date.
- Best Practice: disclose in writing the rate, the terms and the duration of the rate lock.
- Then process the loan promptly, before rate lock expires.

## 8. “Adverse Action” Notices

- ECOA requires lender who has received completed application to notify borrower in writing within 30 days of reasons for rejection, the acceptance or counteroffer.
- If loan is rejected or counteroffer is not accepted, then lender must send Adverse Action Notice.
- Failure to do so = \$100 to \$1,000 statutory penalty under FCRA; up to \$10,000 for ECOA.

## 9. Unreasonable or Inflated Settlement Fees

- Appraisal charges
  - Document preparation fees
  - Settlement charges
  - Credit report charges
  - Title search
  - Flood search
- Can be basis for rescission
  - Unreasonable charges must be included in the TILA finance charge
  - Can convert loan into high cost HOEPA loan or violation of state predatory lending laws.

# What You Should Do

- Procedures Manuals – Make sure that they are up to date.
- Training – Ensure that what you say in the Procedures Manual is actually what happens in the field.
- Find those “back door” processes that work around well defined procedures and fix them. (E.g., so what if your direct origination process is perfect, if the broker channel or that branch office is still unruly.)
- Weed out the bad apple vendors.