

STATE REGULATORY UPDATE: PREDATORY LENDING

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Mortgage Bankers Association of America

Quality Assurance Conference

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STATE AND LOCAL INITIATIVES

- **Recent initiatives to legislate and regulate “high cost home loans” (HCHL’s) in states, counties, and cities**
- **Comprehensive state statutes:**
 - NC, TX, CT, PA, DC, NY, FL, OH, CA, GA, WV, MD, CO, KY, NM, NJ, OK, VA, NV, MI, AR, ME, SC, IL (pending)
- **State Banking Regulations:**
 - NY, MA, IL
- **Cities/Counties:**
 - Chicago, Philadelphia, Dayton, Oakland, Dekalb (GA), Cook (IL), Atlanta, NYC, LA, Cleveland, Toledo

STATE AND LOCAL INITIATIVES (cont'd)

- **Over 35 states and localities have at least considered HCHL laws, regs or ordinances**
- **“Spot” bills in some states – aimed at specific practices**
- **Related legislation – closer regulation of mortgage brokers and sales/origination – AL, NC, FL, OH, NE, others**

TERMINOLOGY - ??

- **Confusing nomenclature –**
 - **“Subprime,” “non-conforming,” “B/C credit,” “high-risk,” “high-cost”**
 - **“Predatory” lending**
 - **Not every subprime home mortgage loan “predatory”**
 - **Unfortunately, the “p” word is now in common usage**

A DEFINITION?

- **Definition of “predatory lending”?**
 - **No simple formula – depends on who’s “using it”**
 - **A group of lending terms and practices that appear unfair or overreaching**
 - **More like a “know it when you see it” test**
 - **List of perceived problems growing, as more people look at it – e.g. CA law**
 - **Courts are working on it!**

EXAMPLES OF PRACTICES

- **“Flipping” or repeated refinancings with escalating balances**
- **Charging (and financing) of excessive points and fees (relying upon federal preemption)**
- **Marketing-driven sales practices, such as loans made to borrowers who can't repay (“asset based” lending)**

EXAMPLES OF PRACTICES

(Cont'd)

- **Non-disclosure of loan terms, such as balloon payments**
- **Mandatory arbitration of disputes**
- **Financing of single-premium credit insurance/credit insurance “packing”**
- **Excessive prepayment penalties**
- **“Green-lining” or heavy marketing emphasis on minority, elderly and poor communities**

EXAMPLES OF PRACTICES

(Cont'd)

- **Intentional foreclosure tactics, leading to “equity stripping”**
- **Non-reporting of credit information**
- **Excessive default interest rates, excessive modification/deferral fees, “junk” fees**
- **Home improvement contractor abuses**
- **Outright fraud and “hot box” sales practices**

WHY SHOULD CONFORMING LENDERS CARE?

- **Structure of laws: “thresholds” – intent irrelevant!**
- **“Threshold creep” – as low as 3% above T-bills, as few as 3 points**
- **Broader than HOEPA – including PMM’s and HELOC’s**
- **Not safe to conclude “no HOEPA, no problem” – different thresholds**
- **“You may be there already”**

WHY SHOULD CONFORMING LENDERS CARE? (Cont'd)

- **Remedial consequences – UDTPA, class action risk**
- **Regulatory risk – OCC, FDIC, OTC and state banking commission oversight**
- **GSE's (Fannie, Freddie) won't buy**
- **Impairment of non-GSE secondary market – loans can't be sold**

WHY SHOULD CONFORMING LENDERS CARE? (Cont'd)

- **BAD PUBLICITY – being branded as “predator” – intense interest by local and national media**
- **Emerging theories of liability, in state and federal courts – such as Lehman/FAMCO case**
- **Fair lending concerns – disproportionate impact on elderly, minorities**
- **“Active activists” – ACORN, NACA, NCLC, CRL/NC, AARP, NAACP, Greenlining Institute, et al.**

THE “DESIGN” OF STATE LAWS

- **HOEPA-based, using thresholds or “triggers”**
- **Rates: 3-10% above comparable treasuries**
- **Fees: 3-8% (broadly defined)**
- **Prepayment fees: 2% (NC)**

THE “DESIGN” OF STATE LAWS (Cont’d)

- **If exceed “triggers,” becomes a “high-cost home loan” or “high-risk home loan” (IL) or even a “predatory loan” (municipal ordinances)**
 - **Then, restrictions, limitations and prohibitions apply—**
 - AND**
 - **Violations are unfair and deceptive trade practices**

HCHL LIMITATIONS AND RESTRICTIONS

- **No balloon payments, negative am, financing of points and fees, financing of credit insurance, default interest**
- **Home ownership counseling required**
- **No “asset based” lending – lender must determine that the borrower can repay**
- **Additional, special disclosures**

HCHL LIMITATIONS AND RESTRICTIONS (Cont'd)

- **No “oppressive mandatory arbitration**
- **Credit reporting required**
- **Foreclosure practices and protections**
- **No single premium credit insurance**
- **Restrictions/limitations on prepayment fees**

BENEFIT TO BORROWER

- **“Flipping” – making a mortgage loan when there is “no reasonable tangible net benefit to borrower under all of the circumstances”**
- **Subjective test – no way to use a one-size-fits-all “worksheet”**
- **Prohibition commonly applies even when lender not refinancing its own loan**
- **Discourages refinancing transactions in general**

COUNTY AND MUNICIPAL ORDINANCES

- **Common “structure” – HCHL’s became “predatory” if have certain features**
- **“Doing business” restrictions –**
- **Lenders who make HCHL’s or “predatory loans” prohibited from doing business with cities or counties**
- **Potential for private rights of action**

QC & QA CHALLENGES

- “Hodgepodge” regulation
- “Cure” opportunities very limited, and intent irrelevant
- References to HOEPA but using different “math” for APR, finance charges
- Subjective standards – e.g., anti-flipping

QA & QC CHALLENGES

(Cont'd)

- **“Points and fees” calculations – HOEPA based, but may include or exclude various items – very complicated**
- **Exclusion of “bona fide discount points” unworkable**
- **Government insured programs (VA, FHA) “over the line,” even though not “predatory” by any measure**
- **Inclusion of prepayment fees problematical**

QA & QC CHALLENGES (Cont'd)

- **Special disclosures – what and when?**
- **Servicing issues**
 - Special notices
 - Enforcement risks and new foreclosure defenses
 - Claims management and mitigation
- **Securitizations and secondary market transactions**
 - “High-cost” cannot be sold
 - Special reps & warranties
 - Additional diligence and certifications

THE CONSEQUENCES TO QA & QC

- **New multi-state compliance programs**
- **“Avoidance” rather than compliance – need to check every loan file to be sure not tripping the triggers**
- **Manual or spreadsheet–based checking inefficient, inaccurate**
- **Data for calculations changes every day – e.g. T-rates**
- **With “traditional” QC procedures, difficult/impossible to check every loan**
- **Traditional QC/QA may not be good enough
– loans will be rejected for purchase**

HELP ON THE WAY?

- **Automated compliance solutions (ACS) now available**
- **Automated testing of home mortgage loan law compliance, including “predatory lending” rules**
 - **Data pulled directly from LOS**
 - **Real-time testing and “alerts”**
 - **Sophisticated reporting and background analysis**

AUTOMATED COMPLIANCE SOLUTIONS

- **May be installed as enterprise software or used as internet ASP**
- **Satisfaction of internal and secondary/investor guidelines in seconds**
- **Third-party reporting/certifications, to satisfy investor and rating agency due diligence requirements**
- **Cheaper, quicker, more efficient than traditional/manual QC & QA**
- **Multiple “checks” may be done, pre-close and post-close**

AUTOMATED COMPLIANCE SOLUTIONS (cont'd)

- **Testing includes other laws, as well**
 - HMDA
 - USAPATRIOT
 - Anti-fraud
 - Tax cert. & flood cert.
- **Leading ACS provider: ComplianceEase (CE)**
 - Based in San Francisco
 - www.complianceease.com
 - Mortgage-focused solutions
- **Other providers include Mavent, ExperITy/Pci, Appintell**

OTHER QA & QC ISSUES

- **Re-examination of broker and origination channels – closer scrutiny**
- **Reexamination of servicing relationships, including loss mitigation and consumer complaint resolution**
- **Being prepared to repo loans that “fail”**
- **Staying current on the state law developments – rapidly changing, emerging**

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