

WBSK MORTGAGE FINANCE NEWSLETTER

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Federal Regulators Propose Model Privacy Form

The federal agencies (OCC, Federal Reserve Board, FDIC, OTS, NCUA, FTC, CFTC and SEC, collectively the "Agencies") responsible for implementing and enforcing the privacy provisions of the Gramm-Leach-Bliley Act ("GLB Act") have jointly developed a "model privacy form," as required under § 728 of the Financial Services Regulatory Relief Act of 2006. Financial institutions which elect to use the "model privacy form," once it obtains final approval, will enjoy the benefit of

a safe harbor for compliance.

The "model privacy form" was developed in response to growing concern expressed by representatives of financial institutions, consumers, as well as Congress that the current privacy disclosure forms mandated under the GLB Act are complex and without utility. The Agencies went about the process according to a carefully designed set of research objectives, including creating a privacy notice that consumers could more easily understand and use, that facilitated

comparison of sharing practices and policies across privacy notices, and that addressed all relevant legal requirements of the GLB Act and the Fair Credit Reporting Act. The Agencies believe that the proposed model form satisfies all requirements of the GLB Act in addition to being shorter, simpler, and more readable than most privacy notices currently being disseminated.

The proposed model form contains either two or three pages, depending on the practices of financial institutions subject to the privacy rules. The third page of the proposed model will be an opt-out form, and its inclusion in the privacy notice is required only if a financial institution either shares or uses consumer information in a manner that triggers an opt-out or when a financial institution chooses to provide opt-outs beyond what is required by law. Generally speaking, a financial institution whose privacy policy provides for broad information sharing will be required to include a consumer opt-out, while those financial institutions whose privacy policy limits information sharing will not be required to include the opt-out form.

Comments regarding the proposed "model privacy form" must be submitted on or before May 29, 2007 to the applicable agency. Following the receipt of comments, the Agencies expect to conduct a round of quantitative testing to measure the effectiveness of the newly developed form among a larger number of consumers. ■

IRS Issues Instructions for Reporting Deductible Mortgage Insurance Premiums

In the waning days of 2006, Congress pushed through the Tax Relief and Health Care Act of 2006, which included a provision to treat mortgage insurance premiums paid by eligible homeowners as "qualified resident interest" for tax purposes. Accordingly, for loans made in 2007, taxpayers who do not exceed the income limitations will have their mortgage insurance premiums treated as interest for income tax purposes. The amount of insurance premiums paid that will be treated as interest will be reduced by 10 percent for each \$1,000 of the taxpayers' adjusted gross income that exceeds \$100,000. The reduction will be 10 percent for each \$500 that the adjusted gross income of a married taxpayer filing separately exceeds \$50,000. The provision is set to expire after December 31, 2007.

The Internal Revenue Service recently issued the 2007 Form 1098 Mortgage Interest Statement. The form contains a new box 4 for reporting mortgage insurance premiums. The instructions to the 1098 form clarify that only premiums of \$600 or more that were paid or accrued in 2007 for qualified mortgage insurance should be reported. Qualified mortgage insurance means mortgage insurance on a loan issued after December 31, 2006 and provided by the Veterans Administration, the Federal Housing Administration or the Rural Housing Administration, as well as private mortgage insurance.



Firm Offers of Credit under FCRA

Two recent rulings in the Southern District of New York dismissed complaints alleging willful violations of the Fair Credit Reporting Act (“FCRA”), 15 U.S.C. § 1681 et seq. In *Nasca v. JP Morgan Chase Bank, N.A. et al.* and *Soroka v. JP Morgan Chase & Co., et al.*, the respective plaintiffs alleged that Chase Manhattan (“Chase”) obtained plaintiffs’ credit reports in connection with solicitations to enter credit transactions and then failed to extend to those plaintiffs firm offers of credit. Both matters were ultimately dismissed with prejudice after the Courts found that firm offers of credit had in fact been extended.

The facts of each case are nearly identical. Plaintiffs Karen Nasca and George Soroka each received mailed solicitations from Chase, stating that they had pre-qualified for loans from Chase. Prior to mailing those solicitations, Chase had prescreened the plaintiffs’ consumer reports without the plaintiffs’ prior authorization. Plaintiffs therefore claimed that those solicitations did not constitute firm offers of credit because the offers provided no details regarding important loan terms, such as the interest rate and specific credit amounts. In their complaints, plaintiffs contended that Chase did not use their consumer reports for a “permissible purpose” as required by the FCRA. [Soroka further alleged that Chase’s solicitation failed to make the FCRA-required disclosures “clear and conspicuous” under section 1681m(d) of the FCRA. The Court held that the FCRA explicitly provides that no private right of action exists for violations of section 1681m(d).] Chase moved to dismiss each complaint.

In granting the motions to dismiss, the *Nasca* and *Soroka* Courts did acknowledge a primary purpose of the FCRA, namely to preserve consumer privacy when creditors seek access to a consumer’s credit report. In keeping with that objective, where the creditor accesses a consumer’s credit report for use in a firm offer of credit, and the consumer has not initiated the transaction, the FCRA requires the creditor to make certain disclosures in extending the firm offer. The Courts therefore looked to the plain meaning of the FCRA, which explicitly defines “firm offer” and enumerates the disclosure requirements when a firm offer is being extended. The Courts found that

the FCRA permits a creditor to make the firm offer contingent upon the consumer meeting certain conditions in order to effectively accept the offer of credit. The Courts also found that the FCRA does not require a creditor to disclose specific interest rates or all credit terms in firm offers of credit made pursuant to the statute. The *Nasca* Court noted that the FCRA only requires disclosure of one particular credit term – the disclosure of any requirement of collateral – and Chase had in fact made that disclosure.

Both Courts also noted that the Seventh Circuit case of *Cole v. U.S. Capital, Inc.* – which held that defendants’ letter offering credit violated the FCRA and was relied upon by both *Nasca* and *Soroka* – was inapposite to the present actions. ■

Rhode Island Extends Loan Protection Act Regulations

The Rhode Island Home Loan Protection Act, enacted by the Rhode Island legislature in 2006, created a Rhode Island law designed to combat abusive lending practices. The law, effective on December 31, 2006, creates a class of “high cost home loans” based on APR and “points and fees” thresholds. The law also imposes certain restrictions with respect to “home loans” (i.e., mortgage loans that may not necessarily be classified as high cost home loans), including an “anti-flipping” prohibition unless a “net tangible benefit” to the borrower can be demonstrated. For a detailed discussion of these provisions of the law applicable to high cost home loans and home loans, see the January 2007 edition of the WBSK Mortgage Finance Newsletter.

On December 29, 2006, the Department of Business Regulation (the “Department”) issued an emergency regulation in order to provide guidelines and interpretations for complying with the new law (“Emergency Regulation 3”). Emergency Regulation 3 was to be effective for a period not exceeding one hundred twenty (120) days. Section Seven (7) of the Emergency Regulation 3 provides that the Department will not take any enforcement actions in connection with such regulatory requirements for any issues related to the use of disclosures prior to February 1, 2007. This period was

extended from March 1, 2007 to April 1, 2007. In Banking Bulletin 2007-4, issued on March 28, 2007, the Department announced that it has again extended the effective date from April 1, 2007 to June 1, 2007.

All applicants for loans must be provided within three (3) days of application with two disclosures, one entitled “Prohibited Acts and Practices Disclosure Regarding All Home Loans” (Form 1 HPLA), and another entitled “Prohibited Acts and Practices Disclosure Regarding High Cost Home Loans” (Form 2 HPLA). Further, any applicant whose loan falls under the anti-flipping provisions must be provided with a disclosure entitled “Rhode Island Home Loan Protection Act Disclosure – Tangible Net Benefit” (Form 3 HPLA). Any applicant applying for a high cost home loan must receive a disclosure entitled “Rhode Island Home Loan Protection Act Disclosure - High Cost Home Loan” (Form 4 HPLA). Also, if a borrower will obtain a high cost home loan, the lender or loan broker must provide to the prospective borrower a disclosure regarding the advisability of shopping for another loan and seeking out counseling (“Rhode Island Home Loan Protection Act Disclosure – Consumer Caution”, Form 5 HPLA). HPLA Forms 3, 4 and 5 must be provided as soon as such coverage is determined but no later than ten (10) business days prior to the closing of the loan. The exact disclosures as published in the Appendices to the Regulation must be used and may not be altered in any way. The covered lender’s or loan broker’s employee performing the tangible net benefit and high cost tests must sign documents indicating that the tests have been performed, and such documents must be kept by the lender or broker for inspection by the Department. Lenders or loan brokers subject to the law must also keep a record of high cost home loans and loans where a tangible net benefit existed.

On March 8, 2007, the Department held a hearing on Emergency Regulation 3 and considered the testimony and information offered at that hearing in finalizing amendments to Regulation 3. The Department planned to issue a permanent regulation by April 10, 2007. The permanent Regulation 3 will be effective May 1, 2007; however, the extension of only Section 7 to June 1, 2007 (for enforcement actions related to regulatory disclosures), announced in Banking Bulletin 2007-4 on March 28, 2007, is to be incorporated in the permanent Regulation 3.

Thus, although Emergency Regulation 3 is scheduled to expire on April 30, 2007 (and the permanent Regulation 3 will become effective on May 1, 2007), any enforcement actions related to the disclosure requirements will cover only those transactions initiated or pending after June 1, 2007. Persons covered by the new law must comply with all disclosure requirements as of June 1, 2007. ■

Fannie Mae and Freddie Mac Announce Master and Short Form Uniform Security Instruments

On February 21, 2007, Fannie Mae and Freddie Mac announced the upcoming availability of their newly developed master and short form uniform security instruments. The GSEs developed the forms jointly. The forms should be available in the early spring of 2007.

Many states' laws provide a method by which lenders may record a master form security instrument and then subsequently record a shorter form for each mortgage loan originated and recorded in a particular locality. The short form contains loan-specific information, such as the borrower's name, the lender's name, the loan amount, a description of property, and incorporates the master form into the short form. Lenders also provide borrowers with a copy of the recorded master mortgage.

Fannie Mae and Freddie Mac anticipate that the master and short form security instruments will be available for use in up to 27 states, the laws of which provide for master/short form security instruments, as follows: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Idaho, Kentucky, Maine, Maryland, Nebraska, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Washington, Wisconsin, and Wyoming.

Use of the master and short form security instruments should reduce recording fee expenses in those residential mortgage transactions in which such forms are utilized. ■

WEST VIRGINIA—New Licensing Requirements

West Virginia has amended its Residential Mortgage Lender, Broker and Servicer Act, effective June 6, 2007, to require an entity holding both a mortgage lender and broker license to license its individual loan originators when the majority of the entity's residential mortgage loan transactions are brokered transactions. The determination of whether the entity brokers a majority of its residential mortgage loans will be based upon the most recent annual report filed with the Division of Banking. New applicants for both a mortgage lender license and a mortgage broker license must license all of its loan originators unless the new applicant can demonstrate, through data compiled for other state regulators, that it acts as a lender for the majority of its residential mortgage loans made.

SOUTH DAKOTA— Requirements Change for Loan Originators

South Dakota has repealed and reenacted the provisions of the Mortgage Lender Business Statute. Under the new law, effective July 1, 2007, mortgage loan originators are required to be registered as of December 31, 2007. Additionally, mortgage lenders and brokers must maintain a surety bond in the amount of \$25,000, submit to a criminal background check, and have at least two years of experience prior to initial licensing. The annual renewal date for mortgage lender and broker licenses has been changed to December 1st.

Illinois Governor Directs Revised Predatory Pilot Program Regulations

On January 19, 2007, the Governor had directed the Illinois Department of Financial and Professional Regulation (the "DFPR") to suspend the Pilot Program as provided in Illinois House Bill 4050 enacted by the Illinois legislature in 2005. On March 21, 2007, the Governor directed the DFPR to file new regulations to implement the Illinois Predatory Lending Pilot Program. Under the revised regulations as proposed, the "Pilot Program" is to include all of Cook County, Illinois.

The regulations continue to require a broker or originator to submit certain detailed information regarding the borrower and the mortgage loan transaction for inclusion in the predatory lending database. However, in addition to the previously

required information, the proposed regulations also will require a broker or originator to submit the information on whether the loan: (i) permits interest only payments, (ii) may result in negative amortization, (iii) provides for total points and fees payable by the borrower at or before closing that exceed 5% of the loan amount, (iv) relies on stated income, (v) the loan includes a simultaneous 100% second-lien loan, (vi) includes a pre-payment penalty, or (vii) is an ARM. A borrower must be recommended for counseling if, after reviewing the information in the Predatory Lending Database, the DFPR finds the borrower is a first time homebuyer or is obtaining a refinancing and the loan includes one or more of the above terms or conditions.

Borrowers applying for a reverse mortgage loan, including under programs regulated by the Federal Housing Authority (FHA) that require HUD-certified counseling, are exempt from the Pilot Program and may submit a HUD counseling certificate as a method to demonstrate eligibility for such exemption from the Pilot Program. ■

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