

WBSK MORTGAGE FINANCE NEWSLETTER

A PUBLICATION OF WEINER BRODSKY SIDMAN KIDER PC

Reminder:

Launch of National Mortgage Licensing System Approaching

On January 2, 2008, the Conference of State Bank Supervisors, the American Association of Residential Mortgage Regulators, and the Financial Industry Regulatory Authority will launch the National Mortgage Licensing System ("NMLS"). In connection with this January launch, certain state regulatory agencies requested that their licensees elect to "pre-entitle" to utilize the NMLS during the Fall. Although the pre-entitlement stage has now passed, licensees that did not complete the pre-entitlement process before the deadline will be permitted to complete the entitlement process and utilize the system beginning on January 2, 2008.

As of January 2, 2008, the following regulatory agencies will require use of the NMLS: (1) Idaho Department of Finance; (2) Iowa Division of Banking; (3) Kentucky Office of Financial Institutions; (4) Massachusetts Division of Banks; (5) Nebraska Department of Banking and Finance; (6) New York State Banking Department, but only for Loan Originator licensing; and (7) Rhode Island Department of Business Regulation, Division of Banking and Securities.



District of Columbia Enacts New Non-Conventional Mortgage Disclosure Law

On November 27, 2007, the Mayor of the District of Columbia signed the Mortgage Disclosure Amendment Act of 2007, which amends the District of Columbia Mortgage Lender and Broker Act of 1996. The new law requires mortgage lenders to provide clear and complete information to District of Columbia consumers within three business days of receipt of an application for a "non-conventional mortgage loan." A non-conventional mortgage loan is defined as any mortgage loan that is other than a fixed-rate mortgage loan with an amortization period of 30 years or less. The written disclosures must be printed on a single page, front and back, and must include certain information, including monthly payment amounts required at the: (i) beginning of the loan, (ii) time the fully-indexed rate is charged, and (iii) highest rate of interest possible under the loan terms. The calculation of the monthly payments includes real property taxes and hazard insurance premiums. Lenders must also disclose any balloon payment and prepayment penalties, including the amount of the penalty and when it may be imposed. A non-conventional mortgage loan may not be consummated unless the borrower signs the required disclosures and returns the disclosures to the lender. The disclosure must be provided in plain English or in the language of the mortgage lender's presentation to the borrower - presumably, the language used to market and or negotiate the transaction. A borrower has five business days following the receipt of the disclosure to cancel the loan application with no loss of any security deposit or any other funds applied to guarantee an interest rate, not including reasonable fees incurred to process the application. The borrower must be notified of the right to cancel at the time the mortgage lender provides the disclosure. The new disclosure requirement will apply 30 days after the period of Congressional review and publication in the District of Columbia Register. A lender's failure to provide the new disclosure is an unfair trade practice.

Second Circuit Denies States' Enforcement Power Over National Banks

In an opinion issued on December 4, 2007 deciding the matters of *The Clearing House Association, LLC v. Cuomo* and *OCC v. Cuomo*, the Second Circuit has affirmed the lower court's ruling barring the New York State Attorney General from "investigating national banks and their operating subsidiaries for possible violations of federal and state fair lending laws."

The lawsuit originated in 2005 when the New York State Attorney General launched an investigation into the purported racially discriminatory real estate lending practices of several national banks. In examining the publicly available data provided for under the federal Home Mortgage Disclosure Act ("HMDA"),

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the Attorney General noted that African-Americans were being issued a higher portion of high interest home mortgage loans. The discovery of these disparities prompted the Attorney General to issue "letters of inquiry" in lieu of formal subpoenas to mortgage lenders – including national banks – that had been implicated by the data. The letters suggested that the data evidenced potential violations of several state and federal anti-discrimination laws.

Both the Office of the Comptroller of the Currency ("OCC") and The Clearing House Association, a consortium of national banks, filed separate complaints in the United States District Court for the Southern District of New York, seeking to enjoin the Attorney General's efforts. The OCC specifically relied on one of its recent regulations that had broadly interpreted the visitorial provision of the National Bank Act ("NBA"), which prohibits state officials from enforcing national banks' compliance with the NBA. The Attorney General counter-claimed, asserting that his investigation was not in conflict with the NBA's visitorial provision and that in the alternative, he was empowered to sue under the Fair Housing Act ("FHA"). After a trial on the merits, the district court deferred to the OCC's interpretation and agreed that the attorney general's investigation was prohibited. The district court also agreed with Clearing House by holding that the FHA did not create an exception authorizing the exercise of visitorial provisions otherwise prohibited by the NBA.

On appeal, the Second Circuit affirmed the district court's ruling in *OCC v. Spitzer* but affirmed in part and vacated in part the ruling in *Clearinghouse v. Spitzer*. The Second Circuit "affirmed that part of the Clearing House judgment granting Clearing House the injunctive relief provided in *OCC v. Spitzer*" but vacated the judgment granting permanent enforcement of the FHA. The Court reasoned that "the district court lacked jurisdiction to decide the FHA claim" and therefore remanded the case to the district court with instructions to dismiss."

This Second Circuit's decision to accept the OCC's position on the degree to which the NBA pre-empts state enforcement activities against national banks is also aligned with the legal principles recently set forth in the U.S. Supreme Court decision of *Watters v. Wachovia Bank, N.A.*

Bankruptcy Abuse: Residential Mortgage Servicers In The Crosshairs

Abusive and fraudulent conduct by individual debtors played a major role in convincing Congress to reform the Bankruptcy Code. The much debated Bankruptcy Abuse and Consumer Protection Act of 2005 resulted. Under this statutory mandate, the United States Trustee Program, within the auspices of the Department of Justice, significantly increased its efforts to find and combat abusive and/or fraudulent bankruptcy activities. These increased efforts, or "Civil Enforcement Initiative," were recently described by the Director of the Executive Office for the United States Trustees, Clifford J. White, III, during oversight hearings before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, U.S. House of Representatives. In a written statement on October 2, 2007, Mr. White explained: "One of the core functions of the USTP [United States Trustee Program] is to combat bankruptcy fraud and abuse."

In fulfilling this "core function," the USTP enlists the support and participation of the public. Websites maintained by the regional USTP offices prominently solicit information about debtors who fail to report assets in their bankruptcy cases. For example, placed in the center of the USTP Region 7 homepage is the following:

REPORT BANKRUPTCY FRAUD

BANKRUPTCY FRAUD
Detecting and combating Bankruptcy Fraud is a U.S. Trustee Program priority. For information on how to report suspected bankruptcy fraud, click here.

All of this is welcome news to consumer creditors. Abusive bankruptcy behavior by individual debtors is a fairly common experience for consumer creditors.

A little less well known is the "balanced approach" of the USTP's Civil Enforcement Initiative. In his October 2,

2007 Statement, Mr. Clifford explained to the Subcommittee that the Initiative addresses not only "wrongdoing by debtors" but also wrongdoing "by those who exploit debtors." Mr. White stated:

An important component of the Program's civil enforcement efforts has been to protect consumer debtors. These enforcement efforts often involve actions against debtors' counsel, non-attorney bankruptcy petition preparers (BPPs), or other third parties. In the first nine months of FY 2007, the Program took 394 formal actions against debtors' counsel and 184 actions against petition preparers.

From these comments, it would be easy to conclude that the USTP is primarily concerned with parties *other than creditors*, such as attorneys who abuse or neglect their debtor clients. Such a conclusion would, however, be erroneous. According to well-placed sources, there has recently been a very distinct shift in focus by the USTP Initiative. This shift in the USTP Initiative is taking place with the worst housing and mortgage market that the industry has experienced in many years, and at a time when the media is increasingly focused upon the subprime mortgage crisis. Also, there currently are efforts in Congress to consider mortgage loan modifications in bankruptcy. This shift in focus is of particular interest to the readers of this Newsletter, because it involves increased scrutiny of residential mortgage servicers.

The USTP is now actively soliciting referrals from assistant U.S. Trustees and Chapter 7 and 13 Trustees for a number of items, including:

- False, inaccurate, and/or unsupported pre-petition charges to residential mortgage loan accounts.
- Failures by residential mortgage servicers to account for post petition mortgage payments.
- Assessments of post petition fees or charges to residential mortgage loans.

The seriousness of the USTP's Initiative is exemplified by a case in the Southern District of Texas involving a mortgage servicer. In that case the USTP took depositions of 20 witnesses and participated in 5 days of trial. Similarly, on November 6, 2007, it was reported that the Chapter 13 Trustee in Pittsburgh

asked the bankruptcy court to impose sanctions on a major residential mortgage servicer. According to the article, \$500,000 in mortgage payments had been lost or destroyed between December of 2005 and April of 2007.

On November 28, 2007, reportedly in two bankruptcy cases in Southern Florida, the USTP served deposition subpoenas on a major residential mortgage servicer. Both subpoenas go far beyond the debtors' circumstances in each bankruptcy case. In the Notice of Examination, the USTP states that it seeks to examine a representative about the servicer's "bankruptcy initiatives," and the "impact of those initiatives on the bankruptcy process." Further, one topic of examination is the servicer's "bankruptcy initiatives" to collect from debtors' estates [generally] in Southern Florida [not just the debtor's in these two cases]. Although the servicer has objected to both subpoenas, the objections were largely overruled in one of the cases. The court has not yet addressed the merits of the objections, which include an argument that the subpoena exceeds the statutory authority of the USTP.

These do not appear to be isolated events. Anecdotal evidence suggests that mortgage servicers have often been their own worst enemy. According to a well-placed source, many proofs of claim (POCs) filed by mortgage servicers may invite doubt and scrutiny by the USTP and by Chapter 7 and 13 Trustees. Some POCs fail to itemize or explain the charges accrued pre-petition, and have even used the term "Other" to describe fees and charges assessed to a residential mortgage loan. Other POCs use labels for fees or charges that can only be described as "strange," such as "amortization fees." Perhaps most troubling to the USTP and Chapter 13 Trustees are those instances where a debtor completes his Plan, only to face thousands of dollars of fees and costs that silently accumulated during the bankruptcy.

All of this suggests, rightly or wrongly, that residential mortgage servicers are being profiled on the basis of their bankruptcy activities. Congressional responses to escalating residential foreclosures, and increased media coverage of the housing downturn and subprime mortgages, have created a generally hostile environment for residential mortgage servicers. The prudent mortgage servicer should take appropriate steps, now, to lower its profile in the present climate. A determined investigation by the USTP is the last thing that a mortgage servicer needs in these challenging times.

Written Agreement Required for Commissioned Employees in NY

Mortgage banking firms with employees in New York take note. A number of New York Labor Law provisions recently signed into law affect companies with employees in New York. Prominent among these, one provision now requires that employers put in writing certain terms of employment for commissioned salespersons.

Many mortgage companies already routinely put the basic terms and conditions of employment into written form for their employees, including for at-will employees. We typically viewed this approach as prudent for a variety of reasons. Until now, however, New York law did not require this written agreement approach.

Effective October 16, 2007, however, Section 191 of the New York Labor Law requires that the terms of employment for commissioned salespersons be contained in a writing signed by both the employer and the employee. The agreement must describe how all compensation is calculated and paid during employment, the frequency of reconciliation (if the agreement provides for recoverable draws) and how compensation is earned and paid upon cessation of employment. The new requirement also provides that the employer retain a copy of the agreement for at least three years and make it available to the State Department of Labor (DOL) upon request.

If the employer fails to produce the required agreement upon request from the DOL, the law presumes that the employee's recitation of the terms of the commission arrangement is correct. For this reason, mortgage banking companies with employees in New York must take the necessary steps to reduce to writing the commission arrangements with salespersons. Companies may also want to include other standard terms and conditions in their agreements, and consider taking this opportunity to troubleshoot compensation, exempt-status and related issues.

Fannie Mae Modifies Rules on Interested Party Contributions

Fannie Mae recently announced modifications to its guidelines on Interested Party Concessions (IPCs). Noting that IPCs may be used to artificially inflate or maintain the sales price of a property, Fannie Mae announced that it is clarifying and updating its IPC rules, effective immediately.

Fannie Mae's IPC announcement provided clarification on the following issues:

Types of IPCs. Fannie Mae sought to clarify the differences between IPCs that Fannie Mae categorizes as financing concessions and sales concessions;

Calculation of IPCs. Fannie Mae reaffirmed its policy and limits based on occupancy and combined loan-to-value ratio;

Appraisal Review for Transactions with IPCs. Fannie Mae reiterated that lenders must provide appraisers with the sales contract and other information concerning all IPCs for the subject property and related appraisal requirements;

Allowable Uses of IPCs. Fannie Mae emphasized that funds that flow from an interested party to a nonprofit and then to the buyer may not be used for downpayment, and these funds must be included in the IPC calculation.

Fannie Mae's announcement also sought to clarify Fannie Mae's position on payment abatements. Recognizing that the current guidelines have caused some confusion, the announcement made clear that mortgage loans with payment

abatements are ineligible for delivery to Fannie Mae, regardless of whether they are disclosed on the HUD-1. The delivery ineligibility applies not only to directly funded payment abatements, but also to payment abatements funded indirectly through another entity.

In addition to clarifying its current rules, Fannie Mae's announcement provided lenders with new document review guidance for IPC transactions. The guidelines now expressly include a list of documents that lenders should scrutinize, including the sales contract, Good Faith Estimate, Uniform Residential Loan Application (1003), appraisal report, and HUD-1. Fannie Mae explained that "[a]ll elements of the transaction must flow logically."

Fannie Mae listed particular "areas of concern" in the IPC area, including: cash-back on purchase transactions; payment of condominium, PUD or cooperative fees; PITI abatements; contributions and subordinate financing disclosed for the first time on the HUD-1; excessive

marketing or commission fees; and below market interest rates with no buydown subsidy listed on the HUD-1.

Fannie Mae reiterated that the "lender is ultimately responsible" for ensuring that the transaction meets Fannie Mae's guidelines. In the current market where

financing and sales concessions are common, and in light of current market conditions, lenders should keep in mind contribution limits of investors and government entities (e.g., Fannie Mae, FHA, VA and Freddie Mac), and closely monitor changes.

States Licensing Update

COLORADO – Requires Errors and Omissions Insurance for Mortgage Brokers

Effective November 13, 2007, the Colorado Division of Real Estate adopted an emergency rule setting the amount and terms of Errors and Omissions Insurance required for Mortgage Brokers. Each individually licensed Mortgage Broker must maintain coverage of no less than \$100,000 per covered claim, with an annual aggregate limit of at least \$300,000. Additionally, the coverage must contain a deductible of no more than \$5,000. Through January 31, 2008, Mortgage Brokers may be in compliance with the requirements if they are an officer, partner, member, exclusive agent, independent contractor, or employee of a mortgage company that maintains errors and omissions insurance covering the individual licensee. After that date, individual Errors and Omissions Insurance coverage will be required for all Mortgage Brokers.

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