

WBSK MORTGAGE FINANCE NEWSLETTER

A PUBLICATION OF WEINER BRODSKY SIDMAN KIDER PC

State Regulators Adopt Nontraditional Mortgage Product Guidance

We recently reported that the Conference of State Bank Supervisors (“CSBS”) and American Association of Residential Mortgage Regulators (“AARMR”) committed to working with state agencies to create guidance for state-licensed mortgage brokers and lenders substantially similar to the guidance issued to their federal counterparts (see WBSK November 2006 Mortgage Finance Newsletter). The CSBS/

AARMR Proposed Guidance on Nontraditional Mortgage Products (“the CSBS/AARMR Guidance”) mirrors the language of the federal Interagency Guidance on Nontraditional Mortgage Products, though sections inapplicable to non-depository institutions were intentionally deleted. As of November 22, 2006, eight states have adopted the CSBS/AARMR Guidance: Connecticut, Georgia, Hawaii, Idaho, Iowa, Montana, New Hampshire and Wyoming. The

Massachusetts Division of Banks has not yet adopted the Guidance, but proposed the Guidance in a Regulatory Bulletin on which it will accept public comments until December 4, 2006. Additional states are expected to adopt the Guidance. For more information on the federal Interagency Guidance on Nontraditional Mortgage Products, please see the February 2006 and November 2006 WBSK Mortgage Finance Newsletters. ■

Cleveland Ordinance Preempted by State Law

On November 20, 2006, in the case of *AFSA v. City of Cleveland*, the Ohio Supreme Court ruled that the state’s general law on mortgage lending (particularly the Ohio “covered loan” law) preempts Cleveland’s anti-predatory lending ordinance. The Home Rule Amendment to the Ohio constitution authorizes municipalities “to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws.” Under the authority of this constitutional provision, the City of Cleveland enacted an anti-predatory lending ordinance that imposed greater restrictions on mortgage companies than those under the state covered loan law in Ohio. In a 5-2 decision, the Ohio Supreme Court held that the Ohio covered loan law was the general law for purposes of Home Rule analysis, and this general law preempted the Cleveland ordinance. The court reasoned that the Ohio covered loan law was the general law, and, because the ordinance imposes stricter limitations on mortgage companies than the general law does, the ordinance conflicts with the general law. Because of this conflict, the general law preempts the ordinance. The decision in *AFSA v. City of Cleveland* resolves a conflict between two Ohio District Courts of Appeal, one holding that the ordinance falls within Cleveland’s home rule power, and another comprehensive opinion finding that predatory lending is not a proper subject for local regulation. The Ohio Supreme Court agreed with the latter opinion, finding the Cleveland ordinance preempted.

Additional Courts Weigh in on Meaning of “Firm Offer” Under FCRA

In connection with the sending of prescreened offers of credit by mortgage lenders and other creditors, courts across the country continue to grapple with the meaning of “firm offer of credit” under the Fair Credit Reporting Act (“FCRA”). The Seventh Circuit has been the most vocal on the issue and very plaintiff-friendly for the most part. While the Seventh Circuit’s decisions are binding only on the district courts in the states that comprise that circuit — Illinois, In-

diana, and Wisconsin — the “value” test it articulated in the case of *Cole v. U.S. Capital, Inc.* continues to influence district court decisions in other circuits as well. Even so, there have been some district court decisions in the Seventh Circuit and other jurisdictions that have stepped outside the confines of *Cole* and produced results more favorable to creditors. Three recent court decisions involving offers of credit for mortgage loans exemplify both the influence of *Cole* as well as the independent reasoning that departs from *Cole*.

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A district judge in the Eastern District of Missouri issued two decisions on the same day that reached contrary results as to whether mailers sent by two different mortgage lenders constituted firm offers of credit. In the first case, *Poehl v. Homeowners Loan Corp., et al.*, the plaintiff received a flyer indicating that he had been pre-selected for a \$92,500 home loan. The offer stated that the loan “may be more or less,” but that \$92,500 was the average amount of actual loans issued by the lender. In the second case, *Klutho v. Home Loan Center, Inc.*, the letter sent to the plaintiff indicated that he was “pre-approved to receive HomeLoanCenter.com’s exclusive SmartLoan Program.” There was a graphic box on the letter showing various loan amounts, payments, and the phrase “SmartLoan program 1.5%/5.646% APR*.” In both cases, the lender defendants moved to dismiss the complaint arguing that their offers were firm offers under the FCRA.

Noting that there are no cases from the Eighth Circuit -- which encompasses Missouri -- addressing this issue, the Missouri court looked to the case law that has developed in the Seventh

Circuit and elsewhere and to the plain language of the statute. In *Cole*, the Seventh Circuit held that an offer of credit must have “sufficient value” to the consumer to justify the accessing of his or her credit; otherwise, such an offer is no more than a sham or the equivalent of an advertisement. In order to make this value determination, the Seventh Circuit instructed that courts look at the entire offer and all of the material conditions that comprise the credit product. The Missouri court discussed several cases that interpreted *Cole* strictly and refused to find firm

offers because all of the material terms were not spelled out on the face of the mailers. The court also cited to contrary decisions that found firm offers of credit despite the absence of specified interest rates or other terms. In particular, the court was persuaded by the decision in *Soroka v. Homeowners Loan Corp.* wherein the Middle District of Florida held that the failure to include more specific terms in an offer for a mortgage loan was not fatal to finding a firm offer since those terms were ascertainable with minimal effort and because “[e]very consumer and every lender has a common understanding that home loans are made for a definite period of time, that banks charge interest for lending money, and that interest rates are subject to change.” The Missouri court also rejected the notion that offers of credit have to be universally appealing. According to the court, just because a particular offer of credit would not appeal to a person with good credit does not mean that it would not have some value to a person with a poor credit history. “It is not the Court’s job to decide whether accepting a particular offer might be unwise. Rather, I need only look to whether

the offer has some value, or more than nominal value, in order to distinguish it from a sales pitch.” Finally, the court looked to the language of the statute and noted that Congress did not specify what, if any, credit terms had to be included for something to be considered a firm offer.

In *Poehl*, the court concluded that the offer of a \$92,500 loan had value and granted the lender’s motion to dismiss. Despite the absence of an interest rate and language stating that the actual loan amount received “may be more or less,” the court found that because \$92,500 was the average amount of loans made by that lender the offer had actual value, as opposed to nominal value. By contrast, in *Klutho*, the court denied the lender’s motion to dismiss.

Among other things, the court noted that “[t]here is no explanation for what the ‘SmartLoan program’ is. Nothing indicates that Klutho was eligible for loans in the amounts listed in the box, or even that the value of his house is somehow tied to any loan offer. The mailing lists some interest rates, and the fine print on the second page contains an incomprehensible statement about interest rates, but it then states that ‘Rates are subject to change without notice.’” The court concluded that a consumer could not regard the offer as having any value and that there was nothing to distinguish it from an unsolicited advertisement.

In another recent case, *Murray v. Indymac Bank, F.S.B.*, a district court in the Northern District of Illinois strictly followed the dictates of *Cole* in granting summary judgment to the plaintiff on the firm offer issue. The mailer in *Murray* did not disclose the terms of the loan or specify an interest rate or the amount of credit available. The mortgage lender urged the court to view the loan transaction as a whole and argued that its initial mailer to the plaintiff need not contain all of the terms of the offer, but rather that ad-

ditional terms could be supplied in later communications. The district court rejected the lender's "course of dealings" argument as contrary to the Seventh Circuit's binding decisions in *Cole and Perry v. First National Bank* where the Court examined only the initial offer letter from the creditor in making the firm offer determination. The court also found that certain statements in the letter negated the possibility of a firm offer. "Although the Letter tells the consumer that his is 'Pre-Approved for a new home loan,' further text indicates that such a statement is not accurate. . . . The Letter read as a whole, merely indicates that the consumer is 'pre-approved' to apply for a loan with IndyMac in the same fashion as would, for example, any other consumer that stumbled onto IndyMac's name in a phone book or saw an advertisement in the newspaper." Further, the court was troubled by the statement that "[r]ates and terms [are] subject to change without notice." The court concluded that the letter did not have value and that it was merely an advertisement.

Although it found that the lender violated the FCRA, the court refused to grant summary judgment to either party on the question of whether the violation was "willful" as required for a finding of liability. As explained by the court, "In order for a party to willfully violate the FCRA, the party must knowingly and intentionally violate [the FCRA], and it must also be conscious that [its] act impinges on the rights of others." The lender asserted that it had no knowledge that its letter violated the FCRA and that it had appropriate compliance procedures in place to avoid any violation. Plaintiff claimed that the lender knew the letter violated the FCRA and that the lender's compliance procedures were inadequate. While concluding that the evidence did not conclusively show that the lender knowingly violated the FCRA and that any deficient procedures on the part of the lender would merely indicate negligence (and hence, no finding of liability), the court nonetheless was unwilling to grant the lender's motion on the issue. According to the court,

Warning: Illinois Governor Announces Crackdown on Unlicensed Loan Originators

On November 3, 2006, Governor Rod R. Blagojevich of Illinois announced the results of the Illinois Mortgage Fraud Task Force ("MFTF"), which has conducted unannounced inspections of the premises of Illinois Residential Mortgage Licensees in order to determine whether such licensees utilized loan originators that were not properly licensed. Since the unannounced inspection process began last March, over 45 companies and individuals have been subject to discipline by the Illinois Department of Financial and Professional Regulation. It is expected that the MFTF will continue to conduct unannounced inspections in order to evaluate compliance with the loan originator licensing requirements.

Utah Prohibits Mortgage Licensees from Acting as Real Estate Licensees

Effective October 11, 2006, the Utah Division of Real Estate amended its regulation that prohibits unprofessional conduct. The regulation was updated to prohibit mortgage licensees from engaging in certain real estate activities while also engaging in mortgage activities. Specifically, mortgage licensees may not: (1) provide a buyer or seller of real estate with comparative market analysis or otherwise assist such person in determining the offering price or sales price of real estate; (2) represent or assist a buyer or seller of real estate in negotiating the possible sale of real estate, except that a mortgage licensee may advise a borrower regarding the consequences that the terms of a purchase agreement may have on the terms and availability of various mortgage products; (3) perform any other acts that require a Utah real estate license; and (4) except in certain instances, advertise the sale of real estate.

“Whether the inadequacy of the efforts taken by IndyMac to ensure that it did not violate the FCRA showed a willful violation of the FCRA is a matter that must be decided by the trier of fact.” ■

DOL Issues Second Opinion on Loan Originators

In a recent item of interest to employers, on September 8, 2006, the U.S. Department of Labor (“DOL”) issued an opinion determining that certain types of loan originators qualify for the federal *Administrative Exemption* under the Fair Labor Standards Act of 1938 (“FLSA”). According to this opinion, employers do not have to comply with minimum wage, overtime and recordkeeping requirements for these types of loan originators. This was DOL’s second opinion regarding loan originators this year. The first opinion, issued at the end of March 2006, dealt with the federal Outside Sales Exemption. (See our May 2006 Newsletter for discussion.)

The mortgage banking industry has long been aware of significant problems under the FLSA with regard to loan originators. Federal and state labor authorities have investigated many companies. Other companies have been sued in individual or class actions. Exposure can be significant. Awards can include double damages and attorneys’ fees.

Unless exempt, the FLSA generally provides that employers must pay a loan originator a minimum hourly wage of at least \$5.15, and 1½ times the loan originator’s regular rate of pay for each hour over 40 worked in a workweek. Recordkeeping requirements also apply. States may have stricter requirements.

Determining whether loan originators qualify as exempt can be tricky. The exemptions most likely applicable are the Outside Sales and Administrative Exemptions. In its September opinion, the DOL primarily addressed the second of the two basic requirements of

the Administrative Exemption.

First, to qualify for the Administrative Exemption, the employee must be paid a *guaranteed salary* of at least \$455 per week. This amount generally cannot be reduced for quantity or quality of work. The September opinion assumed the Employer met this requirement.

Second, the *primary duty* of the loan originator must: (i) be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers, and (ii) include the exercise of discretion and independent judgment with respect to matters of significance. This was the focus of the September opinion.

The opinion indicates that the loan originators described in that opinion qualify as the types of exempt financial services employees provided for as exempt in the current language of the DOL regulations. The opinion points out, however, “an employee whose primary duty is selling financial products does not qualify.”

Note, there are certainly limitations to the issuance. It is based on specific facts. It leaves aside the issue of loan originators in an outbound telemarketing environment. It does not address loan processor employees. It does not address treating draws as the requisite salary. It does not address state law.

That said, the opinion is helpful to lenders seeking to correctly classify loan officers as exempt. Often, careful planning on the front end can go far in limiting possible exposure. ■

Ninth Circuit Rules that Debtor Can Waive Cease Communication Directive Rights

The Ninth Circuit recently ruled that under the “least sophisticated debtor” standard, a debtor may waive the rights granted by the

Fair Debt Collection Practices Act’s (“FDCPA”) cease communications directive.

The case of *Clark v. Capital Credit & Collection Services* concerned bills allegedly incurred by Linda Clark while she was being treated for mental health problems at the Evans & Sullivan Clinic in Beaverton, Oregon. Dr. Evans ultimately bought out Dr. Sullivan’s stake in the business and claimed an interest in all outstanding accounts, including that of Mrs. Clark. After a year of billing disputes, Dr. Evans referred Mrs. Clark’s account to Capital Credit & Collection Services (“Capital”). Capital’s employee, Janine Brumley, and Capital’s attorney, Jeffrey Hasson, sent collection notices to the Clarks. Mr. Clark sent both Brumley and Hasson letters disputing the debt and directing Brumley and Hasson not to call Mrs. Clark either at work or at home, but Mrs. Clark eventually called Hasson’s office to request information about the alleged debt. When Brumley returned Mrs. Clark’s call, the Clarks sued Capital, Brumley, and Hasson under the FDCPA and the Oregon Unfair Debt Collection Practices Act.

The Clarks sought partial summary judgment on their federal claims while Capital, Brumley, and Hasson sought summary judgment on all of the Clarks’ claims. The district court granted Hasson’s motion for summary judgment. The district court denied Capital and Brumley’s summary judgment for the Clarks’ claims relating to Brumley’s telephone call, but granted the motion for summary judgment for the balance of the Clarks’ claims. The district court denied the Clarks’ summary judgment motions entirely.

The Clarks argued that Brumley’s telephone call violated the FDCPA because Mr. Clark had sent letters specifically requesting that Capital not telephone Mrs. Clark at work or home. The FDCPA lists three exemptions for contacting the consumer, none of which includes contacting the consumer at the consumer’s request. The Court examined the types of practices that the FDCPA remedies, and found that “there is nothing inherently abusive, harassing, deceptive or

unfair about a return telephone call.” The Court held that while a debtor may waive the rights created by a cease communication directive, that waiver could only be found where “the least sophisticated debtor would understand that he or she was waiving his or her rights ...”

The Court concluded that Mrs. Clark’s request for information from Hasson constituted consent for Hasson to return her call. The Court concluded that no reasonable fact-finder could decide that Mrs. Clark had not waived her rights with respect to Hasson, and upheld the district court’s judgment in favor of Hasson. However, the Court found that Mrs. Clark’s intent to waive the cease communications directive with respect to Capital and Brumley was unclear. Therefore, the Ninth Circuit reversed the district court’s grant of summary judgment in favor of Capital and Brumley. ■

Lawsuits Challenge Illinois Predatory Lending Database

Recent lawsuits filed in the United States District Court for the Northern District of Illinois, Eastern Division, challenge the permissibility of the Illinois Predatory Lending Database Pilot Program (“Pilot Program”). The Pilot Program impacts individuals residing in the following Cook County zip codes: 60620, 60621, 60623, 60628, 60629, 60632, 60636, 60638, 60643 and 60652 (“Pilot Program Area”).

As reported in previous WBSK Mortgage Finance Newsletters, most recently in the June 2006 newsletter, Illinois House Bill 4050 requires the Illinois Department of Financial and Professional Regulation (“DFPR”) to maintain and administer a predatory lending database. Mortgage brokers and loan originators that originate residential mortgage loans secured by real property located in the Pilot Program Area must submit detailed information about the borrowers, collateral and loan transaction to the DFPR. Upon

States Regulations Update

WASHINGTON, D.C. — Raises Real Property Transfer and Recordation Tax Rates

Effective October 1, 2006, the recordation tax rate in Washington, D.C. increased from 1.1% to 1.45% for security interest instruments submitted for recordation, including real estate mortgages, with respect to all properties, unless the property is otherwise exempt. The Council of the District of Columbia adopted the increase on September 19, 2006 in Resolution 16-791 that declared the existence of an emergency with respect to the need to impose an additional tax of .35% on transfers of security interests. However, security interest instruments on residential properties with five or fewer dwellings are exempt from any deed recordation tax. The measure will also affect transfer and recordation tax rates, which will increase from 1.1% to 1.45% for deeds of title to all commercial properties and those residential properties sold for \$400,000 or greater.

DELAWARE — Attorneys Must Directly Supervise Disbursement of Settlement Funds

In a previous article, we reported that attorneys must oversee the disbursement of settlement funds in South Carolina (See WBSK Mortgage Finance Newsletter, November 2006). On September 22, 2006, the Delaware Supreme Court approved a recommendation and report by the Office of Disciplinary Counsel (“ODC”) for the Delaware State Bar (“the Report”). The Report clarifies the existing ruling of *Mid-Atlantic Settlement Services, Inc. et al.* – which set forth aspects of a real estate settlement that constitute the practice of law. The ODC found that permitting a non-licensed party to receive and be responsible for the disbursement of loan proceeds in a real estate transaction constitutes assisting in the unauthorized practice of law. Thus, according to the Report, attorneys in Delaware must directly supervise the disbursement of funds from real estate transactions, and must do so from their own trust accounts.

TEXAS — Office of Consumer Credit Commissioner Reorganizes Administrative Regulations

Effective November 9, 2006, the Texas Office of the Consumer Credit Commissioner repealed and readopted its administrative regulations in an effort to place the regulations in a more logical location that would be beneficial to its licensees. The new regulations, which are substantially similar to the old regulations, appear at 7 Tex. Admin. Code §§ 83.501-83.863, 86.101-86.102, and 91.701.

receipt of this information, the DFPR will evaluate it and determine whether credit counseling is appropriate for each borrower.

The first lawsuit, filed on October 25, 2006 by a mortgage broker, a realtor and an owner of real property in the Pilot Program area, claims that the Pilot Program is the equivalent of state sanctioned redlining, violates the equal protection clause of the U.S.

vacy rights of borrowers in the Pilot Program Area. Mortgage brokers and loan originators must enter the following information into a database about borrowers in the Pilot Program Area: their names, address, social security number or taxpayer identification number, date of birth, and income and expense information contained in the mortgage application.

The second lawsuit, filed on No-

A MORTGAGE BROKER, a realtor and an owner of real property in the Pilot Program area claim that the Pilot Program is the equivalent of state sanctioned redlining

Constitution and violates the privacy rights of borrowers residing in the Pilot Program Area. With regard to the first claim, the complaint alleges that the Pilot Program is state endorsed redlining since many mortgage lenders have decided against lending in the Pilot Program Area. Redlining is the illegal practice of denying credit to applicants based solely on their place of residence without considering whether the applicants are creditworthy.

As for the equal protection claim, the first lawsuit alleges that since only select borrowers residing within the Pilot Program Area are required to undergo credit counseling, these borrowers will represent a disproportionate number of African Americans and Hispanic Americans. The plaintiffs further allege that the Pilot Program violates federal equal protection laws since it does not apply equally to federally chartered banks and state regulated non-depository mortgage companies. Federally chartered depository institutions are generally exempt from the requirements of the Pilot Program, while non-depository state regulated mortgage companies are not.

The complaint also alleges that the Pilot Program compromises the pri-

vacy rights of borrowers in the Pilot Program Area. Mortgage brokers and loan originators must enter the following information into a database about borrowers in the Pilot Program Area: their names, address, social security number or taxpayer identification number, date of birth, and income and expense information contained in the mortgage application.

vember 11, 2006 by two individuals and a real estate agent and property owner, makes similar claims with regard to violations of the federal equal protection law. However, the second lawsuit also alleges violations of the federal Fair Housing Act. The Act generally makes it unlawful to discriminate on the basis of race, color, religion, sex, familial status or national origin. A violation can be based on a showing of discriminatory effect on minorities. According to the complaint, the Pilot Program violates this prohibition since the minority population in the Pilot Program Area is seventy three percent (73%) higher than Cook County as a whole. The second lawsuit further claims that the Pilot Program violates the Illinois Civil Rights Act, which prohibits municipal, county and state government officials from discriminating on the basis of race, color or national origin, since the burdens and effects of the Pilot Program fall disproportionately on minority homebuyers and homeowners. The plaintiffs in this second action allege that they have been unable, with respect to homes in the Pilot Program area, to: (i) obtain financing, or (ii) consummate sales. ■

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