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MORTGAGE FINANCE NEWSLETTER

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Illinois Federal Court Finds Lender Liable in "Firm Offer of Credit" Case

According to at least one district court in the Northern District of Illinois, an offer of credit to a consumer stating that "rates and terms are subject to change" is not a "firm offer of credit" under the federal Fair Credit Reporting Act, 15 U.S.C. § 1681, *et seq.* ("FCRA"). In *Kudlicki v. Farragut Financial Corp.*, No. 05-C-2459 (N.D. Ill. Jan. 20, 2006), the United States District Court for the Northern District of Illinois granted summary judgment to the plaintiff on the question of whether the defendant lender was liable under FCRA for willfully violating the FCRA's permissible purpose requirement in connection with an offer to refinance an auto loan. The court decided as a matter of law that the mailer sent to the plaintiff did not qualify as a "firm offer of credit" under the standards set forth by the Seventh Circuit in *Cole v. U.S. Capital, Inc.*, 389 F3d 719 (7th Cir. 2004) and its more recent decision in *Murray v. GMAC Mortgage Corp.*, ___ F.3d ___, 2006 WL 90081 (7th Cir. Jan. 17, 2006) wherein the circuit court explained: "To decide whether [defendant] has adhered to the [firm offer requirements], a court need only determine whether the four corners of the offer satisfy the statutory definition (as elaborated in *Cole*), and whether the terms are honored when consumers accept."

According to the *Kudlicki* court, "[t]he mailer provided no specific details relating to the amount of credit or the repayment terms, and describes interest rates only as being 'as low as 5.5% APR.'" The mailer also stated that "[r]ates and terms subject to change at any time." The district court concluded that this language precluded the lender's offer from qualifying as a "firm offer of credit" under the FCRA. The *Kudlicki* decision also addressed the lender's defense that it had instituted sufficient measures to comply with the FCRA and, therefore, any violation under the statute certainly was not "willful" (i.e., the key requirement for plaintiff to recover $1,000 in statutory damages, possible punitive damages, and attorneys' fees). The lender offered evidence that the mailer had been reviewed by an in-house compliance officer (apparently a non-attorney), the consumer reporting agency that provided the consumer reports to the lender, as well as by California state regulators. The court rejected the lender's attempt to defend the mailer stating that "[i]t is clear from the most cursory glance at defendant's mailer that no firm offer of credit is being extended, and no compliance examiner could conclude otherwise."

The *Kudkicki* opinion is another in a series of unfavorable decisions being issued in the Seventh Circuit. Whether other circuits will follow suit remains to be seen. ■

AFSA Sues to Block Montgomery County Predatory Lending Measure

Less than one month before the Montgomery County, Maryland anti-predatory lending measure (the "Ordinance ") goes into effect on March 7, 2006, the American Financial Services Association ("AFSA") has filed suit seeking to enjoin the enforcement of the Ordinance on the grounds that it is preempted by state law. [For details on Montgomery County Ordinance 36-04, see the January 2006 edition of the WBSK Mortgage Finance Newsletter.] AFSA asked the court to issue a preliminary and a permanent injunction restricting the ability of Montgomery County to enforce the Ordinance.

AFSA has challenged the legality of several other local ordinances in the past including those passed by local governments in Cleveland, Dayton and Toledo, Ohio, as well as Los Angeles and Oakland, California. In the most recent lawsuit in Maryland, AFSA and seven mortgage brokers doing business in Montgomery County allege that the Ordinance attempts to regulate or prevent specific lending terms and practices. As the lawsuit points out, a Maryland state law provides that only the state may enact a law that regulates extensions of credit.

The Maryland state law, however, does not restrict or otherwise affect the ability of a local government to enact laws or adopt regulations relating to fair housing and civil rights. Thus, unlike other anti-predatory lending ordinances, the Ordinance combats predatory lending by expanding the categories of discriminatory practices in the anti-discrimination provisions of the Montgomery County Code to include certain predatory practices. Nevertheless,

AFSA and the other plaintiffs argue that a local government such as Montgomery County may not legislate in a preempted field (i.e., extensions of credit) by claiming that it is actually regulating in a permissible area (i.e., fair housing and civil rights).

While the outcome of the AFSA lawsuit against Montgomery County is unclear at this time, the result in this case could affect anti-predatory lending efforts in other localities throughout the country. ■

HUD Makes Effort to Relax Closing Cost Restrictions

In late January 2006, HUD issued Mortgagee Letter 2006-04 regarding "Revised Borrower's Closing Cost Guidelines." HUD notes, in the Mortgagee Letter, that it is trying to align its business practices with those of the conventional market. Given the ever shrinking percentage of FHA insured loans, this would appear to be an effort on HUD's part to reverse that trend. However, in our view, HUD's effort still falls short.

The mortgagee letter leaves much unsaid. For example, although the mortgagee letter states that "Mortgagees may charge and collect from mortgagors those customary and reasonable costs necessary to close the mortgage", the only HUD/FHA Handbook (of those with restrictive provisions in this area) that has been rescinded is Handbook 4000.2 REV-3. HUD does not mention the federal regulations governing allowable closing costs, which are still in place and cannot be amended by Mortgagee Letter. Nor does HUD address similar provisions in the Mortgage Credit Analysis Handbook (4155.1), the Direct Endorsement Handbook (4000.4 REV-1), or the Quality Control provisions found in the Mortgagee Approval Handbook (4060.1 Rev-2).

Notwithstanding this uncertainty, it appears that mortgagees are now permitted to collect "reasonable and customary fees" for closing the loan, such as underwriting fees, processing fees, administrative or closing fees, attorney's fees, settlement fees, courier fees, notary fees, etc., provided that the fees are not otherwise limited or precluded by other HUD Handbooks or federal regulations. Of course, mortgagees must be careful as they revise their business practices based on this latest HUD guidance. ■

When Is A Mortgage Broker The Lender's Agent?

Two federal district courts recently considered whether a mortgage lender could potentially be held liable for the acts of a mortgage broker alleged to be the lender's agent. The courts reached different conclusions, albeit under different evidentiary standards.

In *Nave v. Life Bank*, a case decided in November 2005 by Judge Trauger of the United States District Court for the Middle District of Tennessee, two married borrowers sued a mortgage lender, asserting that the lender should be held vicariously liable for certain fraudulent misrepresentations made by the mortgage broker that obtained a loan for the borrowers. The alleged misrepresentations concerned a particular loan product offered by the lender. The borrowers claimed that the broker was the lender's agent and that, accordingly, the agency relationship alone established a basis for fraud liability against the lender. In support of their agency theory, the borrowers pointed to the fact that the lender required the broker to submit to it a variety of information about potential borrowers who met certain prequalification requirements, which the lender then used to determine whether it wanted to extend loans. The borrowers also contended that the lender directed the broker to perform a number of tasks associated with the brokering of loans, including requiring the broker's compliance with applicable local, state and federal laws.

EVIDENCE OF CONTROL IS NEEDED

In ruling on the lender's motion for summary judgment, the *Nave* court found these circumstances did not establish an agency relationship. First, the court stated that the lender's guidelines, "while seemingly extensive, are not indicative of [the lender's] control over [the broker's] means of doing business, but rather were mere tools used by [the lender] to facilitate its selection of qualified borrowers." The court found that the lender did not control the broker (an essential element of an agency relationship) because it did not dictate how the broker solicited loan applications, did not have the ability to terminate the broker's existence if the broker performed in contravention of the loan application package submission agreement, and because the broker originated loans for many different financial institutions other than the lender. Second, the *Nave* court noted that a broker is ordinarily the agent of the first party to employ him and, in that case, the borrowers had been the first to approach the broker for purposes of the loan transaction. Third, the court stated that "under the terms of its commercial contract with the banker and its Broker Disclosure Agreement" with the borrowers, the broker "was working to advance its own interests in obtaining compensation for its brokering," and that an agency relationship is not created when the purpose of the parties' arrangement is to advance interests beyond those of the purported principal alone. Fourth, the court held that, although the broker may have received compensation from the lender for originating the loan, that fact does not by itself necessitate a finding of agency.

The *Nave* court also examined the policy implications of finding an agency relationship between a mortgage lender and broker, observing that, if it found agency on the facts of the case, "the import of such a decision would be that all mortgage brokers who arrange mortgages for lenders under similar circumstances would be the agents of such lenders. Because many mortgage brokers . . . broker loans for more than one lender, this result would have far-reaching implications." Accordingly, the court found that because no agency relationship existed, the lender was not vicariously liable for the broker's fraudulent misrepresentations to the borrowers regarding the loan product.

A BROKER MAY BE A DUAL AGENT

In contrast, in *Plata v. Long Beach Mortgage Co.*, a case decided in December 2005, Judge Fogel of the United States District Court for the Northern District of California, in ruling on a motion to dismiss, determined that a "general boilerplate allegation of agency" between a mortgage lender and mortgage broker initially sufficed to state a claim, subject to later evidentiary proof. Unlike a motion for summary judgment like the one filed in the *Nave* case, on a motion to dismiss, all allegations of material fact in the plaintiffs' complaint are taken as true and construed in the light most favorable to the nonmoving party.

In *Plata*, the borrowers sought to hold the lender vicariously liable for the allegedly negligent acts of the mortgage broker that had originated their loan. (The borrowers also sued the lender directly for negligence, which the court rejected, finding that there is no duty of care owed by a lender to a borrower.) In support of their agency theory, the borrowers' complaint

asserted what the court described as "a general boilerplate allegation of agency among the defendants." Furthermore, the borrowers alleged that the lender paid a yield spread premium to the broker.

In moving to dismiss the negligence claim, the lender argued that: (1) a mortgage broker is always the agent of the borrower, not the agent of the lender and (2) the borrowers had not sufficiently pled an agency relationship between it and the broker. The *Plata* court rejected the lender's first argument, concluding that a mortgage broker is only *customarily* retained by a borrower to act as the borrower's agent in negotiating a loan, and that there is no "bright line rule that a mortgage broker may never be the agent of a lender." The court further noted that certain allegations in the complaint supported the inference that the brokers were not working as agents of the borrowers anyway. The court also rejected the lender's second argument, stating only that, "[u]nder the liberal rules of pleading, Plaintiffs' allegations of agency are sufficient to survive a motion to dismiss." Accordingly, the court denied the lender's motion to dismiss the negligence claim to the extent they were predicated on vicarious liability.

Other recent federal cases deciding the question of whether a mortgage broker is an agent of the lender include *Richardson v. New Century Mortgage Corp.*, a July 2005 decision from the United States District Court for the Northern District of Mississippi, and *Mills v. Equicredit Corp.*, a 2004 decision from the United States District Court for the Eastern District of Michigan, which both held on summary judgment that the broker was not an agent of the lender. ■

States: Licensing Update

CONNECTICUT – New Licensing Forms for First Mortgage Lender/Broker and Secondary Lender/Broker Licensees

The Connecticut Department of Banking's Consumer Credit Division has released new forms on its website that are to be used in connection with certain events including, among others, name changes and address changes.

WASHINGTON – Amends Consumer Loan Regulations

Effective March 1, 2006, the Washington Department of Financial Institutions ("Department") has amended its Consumer Loan Act Regulations to clarify certain licensing and registration requirements. The regulations adopt the Department's position set forth in Interpretive Letter 02-02CL that, upon licensure under the Consumer Loan Act, all Washington loans are subject to the provisions of the Consumer Loan Act, regardless of whether the Consumer Loan License was required to make such loans prior to licensure. The regulations also clarify that branch locations that only conduct underwriting and "other back-office services" and which only have incidental contact with borrowers are not required to be licensed as branch locations. Also, Consumer Loan Licensees now must either use their full business name, as it appears on their license, or include their Consumer Loan License number on all advertisements.

Ameriquest Settlement: Roadmap to Best Practices or Attorneys General Gone Wild?

ACC Capital Holdings Corporation and several of its residential lending subsidiaries, including Ameriquest Mortgage Company (collectively "Ameriquest"), have agreed to a $325 million nationwide setttement with the state attorneys general of forty-nine states and the District of Columbia to resolve claims that Ameriquest engaged in predatory lending practices. The Settlement Agreement, which is effective March 15, 2006, also enjoins Ameriquest from engaging in unfair or deceptive acts or practices and imposes new origination-related requirements upon Ameriquest. These new requirements (most, if not all, of which are not contained in applicable state or federal law) include, among others, (1) providing detailed oral and written disclosures (in addition to those required under applicabble state and federal law), (2) limiting refinances of Ameriquest loans, (3) prohibiting an employee compensation system that is tied to loan fees or closing costs, (4) implementing training courses for employees, (5) using independent loan closers, (6) limiting prepayment penalty periods on variable rate mortgages, and (7) implementing an internal monitoring program to ensure compliance with the Settlement Agreement. In addition, an independent monitor will be appointed and given broad authority to review Ameriquest's lending operations.

The Settlement Agreement raises a number of questions, and its effect on the industry is not yet clear — Should lenders adopt some or all of the requirements as best practices? Will state mortgage regulatory agencies use the settlement as a springboard for mortgage reform? Will the plaintiff's bar attempt to use the Settlement Agreement in their pursuit of "predatory lenders?" These, and other, questions will be answered in the coming months as the industry fully digests the Settlement Agreement and its impact. ■

Illinois Announces Pilot Program Area

On January 27, 2006, the Illinois Department of Financial and Professional Regulation ("the DFPR") announced that the Pilot Program Area for the predatory lending database will consist of the following Cook County zip codes: 60620, 60621, 60623, 60628, 60629, 60632, 60636, 60638, 60643 and 60652. Illinois House Bill 4050 made amendments to the Illinois Residential Real Property Disclosure Act to establish a predatory lending database Pilot Program in Cook County, Illinois. The bill charges the DFPR with the responsibility of designating the Pilot Program Area by zip codes within a designated area. Illinois House Bill 4050 was to become effective on January 1, 2006; however, the DPFR issued revised rules on December 21, 2005 delaying the effective

date of the Pilot Program until the DFPR announces an "inception date." Compliance with the Pilot Program requirements will be required thirty (30) days after an inception date is declared. Although a Pilot Program Area has now been established, to date, the DPFR has not announced an "inception date."

Illinois House Bill 4050 requires the 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 borrower, collateral and transaction to the DFPR. Upon the receipt of this information, the Department will evaluate it and determine whether credit counseling is appropriate for the borrowers. Title and closing agents also must collect data and file a certificate of compliance when recording a security instrument that secures a residential mortgage loan transaction secured by real property located in the Pilot Program Area.

For more details on Illinois House Bill 4050, see the July 2005 edition of the WBSK Mortgage Finance Newsletter. ■

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