

WBSK MORTGAGE FINANCE NEWSLETTER

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Wide-Ranging Bill Addresses Abusive Lending in Ohio

Ohio Senate Bill 185 ("S.B. 185" or the "Act") is designed to further combat abusive practices in residential mortgage loan originations in that state. S.B. 185 endeavors to achieve this purpose by amending several of Ohio laws dealing with mortgage lending, including the Ohio Mortgage Broker Act, high cost home loan provisions, usury laws, and title insurance and consumer protection provisions. S.B. 185 becomes effective January 1, 2007.

Among other things, the Act provides significant additional disclosure requirements for those entities subject to the Mortgage Broker Act. The Act also provides the Ohio Attorney General with enforcement authority over entities subject to the Mortgage Broker Act. S.B. 185 requires a national criminal background check on

all applicants for a mortgage broker certificate or registration, as well as for loan officers and real estate appraisers. The Act also amends Ohio's anti-predatory lending law to lower the "points and fees" threshold for loans over \$25,000 and provides additional protections and requires

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New Virginia Rules Regulate Advertising, Impose Additional Requirements

Virginia has joined a growing number of states that are seeking to stamp out deceptive advertising practices (see companion Oklahoma article). The Virginia Bureau of Financial Institutions has issued new final regulations, effective September 1, 2006, aimed at advertisements published by mortgage lenders and brokers. The new regulations also impose notification requirements on mortgage lenders and brokers following significant events, restrict the use of the word "pre-approval" and make

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Conference of State Bank Supervisors Announces Nationwide Licensing System

The Conference of State Bank Supervisors announced that it has entered into an agreement with the National Association of Securities Dealers to develop a nationwide licensing system on behalf of state residential mortgage regulators. The new Internet-based system is expected to be available during January 2008. The proposed national licensing system and database will include uniform license applications for licensing of entities and individuals. In addition, licensees will be able to renew their licenses and registrations, as well as the licenses and registrations of their loan originators, using the national system and database.

The proposed database will maintain a central repository of information that will contain information regarding licensing, publicly adjudicated enforcement actions, and background data for every licensed mortgage broker, mortgage lender, and loan originator. State mortgage regulatory agencies, licensees, and consumers each will have varying degrees of access to the database.

The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators expect that the national licensing system and database will streamline the licensing process in each of the participating states. At least 30 state regulatory agencies have indicated that they intend to participate in the system. It is expected that between ten and twelve states will implement the national licensing system during 2008, with the remainder implementing the system during 2009 and 2010. ■

more disclosures for covered loans. The Act makes Ohio's anti-predatory lending law applicable to open-end credit plans. The Act further addresses issues involving title agents. S.B. 185 also generally prohibits the appraisal of real estate for a mortgage loan unless the appraiser holds a state certification or licensure. The Act creates the Consumer Education Finance Board that shall analyze efforts directed at consumer education and financial literacy and receive recommendations from other state agencies and coordinate such matters.

OHIO MORTGAGE BROKER ACT

The Act adds an exemption from registration under the Mortgage Broker Act for a credit union service organization ("CUSO") with respect to business engaged in or authorized by such an organization's charter, or a subsidiary or affiliate of a CUSO. The Act also adds education requirements for sole proprietors, operations managers of registrants and loan officers.

The Act requires a registrant to provide additional information with the "mortgage origination disclosure statement." The disclosure statement must include a good faith estimate of the fees the registrant will assess to the borrower. The Act will require the borrower to sign the mortgage origination disclosure statement in order to acknowledge the borrower's receipt.

If there are any changes to the mortgage origination disclosure statement, the Act requires a registrant to provide the borrower with a revised mortgage origination disclosure statement and an explanation of why the changes occurred. This notice of changes to the mortgage origination disclosure statement must be provided at the earlier of 24 hours after the change occurs or 24 hours before the loan closing.

The Act also requires a registrant to provide a GFE as mandated by RESPA, but such GFE must include

a notice in at least 10-point underlined roman style type that discloses the nature of relationship, when the agreement will terminate, that the borrower's signing of the document does not obligate the borrower to obtain a loan through the originator, that the document is not a loan commitment, approval or a rate lock unless otherwise disclosed on a separate rate lock disclosure. The notice also must advise the borrower not to sign the document until the borrower has read and understood the information in it. The notice also must state that the borrower will receive a re-disclosure of any increase in interest rate or if the total sum of disclosed settlement/closing costs increases by 10% or more of the original estimate. Should any such increase occur, mandatory re-disclosure must occur prior to the settlement or close of escrow.

Further, if the loan applied for will exceed 90% of the value of the real property collateral, the registrant must provide the borrower with a statement, in sixteen point bold-face type, that states:

"You are applying for a loan that is more than 90% of your home's value. It will be hard for you to refinance this loan. If you sell your home, you might owe more money on the loan than you get from the sale."

The Act requires that a registrant provide the borrower with a copy of the credit score and report obtained on the borrower in connection with the loan application. And, the registrant must provide the borrower with a copy of an automated valuation model (AVM) report if the registrant uses an AVM to determine the appraisal value of the collateral property used to secure the loan.

Additionally, the Act requires a registrant, not later than twenty-four hours before a loan is closed, to deliver to a borrower a written disclosure that includes: (i) a statement indicating whether property taxes will be escrowed, (ii) a description of what is

covered by the regular monthly payment, including principal, interest, taxes, and insurance, as applicable.

The Act also requires a registrant to timely inform a borrower of any material change in the terms of a loan. The disclosure will be considered timely if the registrant provides the borrower with the revised information not later than 24 hours after the change occurs, or 24 hours before the loan is closed, whichever is earlier. A "material change" means:

(i) a change in the type of loan being offered, such as a fixed or variable rate loan or a loan with a balloon payment, (ii) a change in the term of the loan, as reflected in the number of monthly payments due before a final payment is scheduled to be made, (iii) a change in the interest rate of more than 0.15%, (iv) a change in the regular monthly payment of principal and interest of more than 5%, (v) a change regarding the escrow of taxes or insurance, or (vi) a change regarding the payment of private mortgage insurance. If an increase in the total amount of the fee to be paid by the borrower to the registrant is not disclosed in accordance with the above requirements, the registrant will be required to refund to the borrower the amount by which the fee was increased. If the fee is financed into the loan, the registrant also will be required to refund to the borrower the interest that would accrue over the term of the loan on that excess amount.

The Act also further prohibits a registrant from coercing, inducing or intimidating appraisers, and a registrant may not promise a borrower to refinance a loan at a lower rate or on more favorable terms unless such promise is stated in writing and initialed by the borrower. A registrant also is restricted from owning appraisal companies. Current ownership of appraisers by a registrant generally is grandfathered but subject to an increase in ownership and transfer restrictions. A registrant generally cannot make a referral to an affiliated appraisal company. And, if a regis-

trant makes a referral to a title insurance company or other settlement service provider, certain additional disclosures are required.

The Act also imposes duties on registrants to safeguard and account for any borrower moneys handled, act with reasonable care and diligence and in good faith and fair dealing in connection with any mortgage loan transaction. A borrower may bring an action for damages for a registrant's violation of these requirements, including punitive damages. These requirements do not apply to "wholesale lenders" who do not deal directly with borrowers but enter into mortgage transactions through non-affiliated third party mortgage brokers.

The Act further imposes a duty on registrants to make reasonable efforts to secure a loan from lenders with whom the registrant regularly does business with rates, charges and repayment terms that are advantageous to the borrower.

These above imposed duties do not apply to "wholesale lenders" who do not deal directly with borrowers but enter into mortgage transactions through non-affiliated third party mortgage brokers.

The Act gives the superintendent broader powers to suspend the registration of a registrant without a prior hearing. The Act also provides the Attorney General with enforcement powers against registrants under the Mortgage Broker Act.

OHIO MORTGAGE LOAN ACT

The Act amends the allowable alternative prepayment fee under the Mortgage Loan Act. Under current law, a Mortgage Loan Act registrant may assess a prepayment fee not in excess of 1% of the original principal loan amount. As an alternative, a registrant may assess a prepayment fee in the amount of 3% if pre-paid within the first year of the loan, 2% if pre-paid within the second year and 1% if pre-paid within the third year

from closing. The Act reduces this alternative prepayment fee to 2% if prepaid within the first year and 1% if pre-paid within the second year from closing.

USURY LAW

The Act amends Ohio usury laws that apply to first mortgage loans to provide that no prepayment penalty may be charged on a first lien loan of less than \$75,000 made or arranged by a mortgage broker, loan officer or non-bank mortgage lender. The \$75,000 amount is subject to annual adjustment each January 1st based on the CPI inflation index.

CONSUMER SALES PRACTICES ACT

Significantly, the Act amends Ohio's consumer sales practices law to apply to residential mortgages between mortgage brokers, loan officers or non-bank mortgage lenders, and their customers. A mortgage broker does not include an employee of a bank, savings association, credit union or a CUSO, or subsidiaries thereof, and a loan officer does not include employees of these entities or their subsidiaries. "Loan officer" and "mortgage broker" have the same meaning as defined in the

rates of interest, lending without considering the borrower's ability to repay, "flipping" a mortgage loan, replacing certain zero interest loans, recommending default, pyramiding late fees, requiring the consolidation of two or monthly installments payments in advance from loan proceeds, coercing or attempting to influence an appraiser, and financing credit insurance premiums, among other things. The Act limits assignee liability under these provisions unless the assignee commits a violation of the law or is affiliated with the seller of the loan at the time of the assignment or purchase. The Act directs the Attorney General to consult with the superintendent of financial institutions in promulgating rules under the consumer practices sales law.

HIGH COST HOME LOAN LAW

Currently, the triggers under Ohio's anti-predatory lending law mirror those provided by federal HOEPA. The Act amends the Ohio anti-predatory lending law to provide when the total loan amount is \$25,000 or more, the "points and fees" trigger is 5% of the total loan amount. Points and fees are defined

The act makes it a violation of the consumer sales practices law to knowingly fail to provide disclosures required under state and federal law.

Mortgage Broker Act. A "non-bank mortgage lender" means any person who engages in a consumer transaction in connection with a residential mortgage loans, but does not include the exempted entities listed above or their subsidiaries.

The Act makes it a violation of the consumer sales practices law to knowingly fail to provide disclosures required under state and federal law or knowingly provide a disclosure that includes material misrepresentations. The Act adds a number of practices to its list of unconscionable acts under the consumer sales practices law, including contracting for default

consistently with that term under HOEPA except that all compensation paid directly or indirectly to a mortgage broker from any source are included in points and fees. However, under the Act, Ohio law will exclude up to one percentage point in indirect mortgage broker compensation by any source, and also will exclude fees paid to the FHA or VA to insure the loan. For open-end credit, points and fees include plan access fees and "maximum limit" fees. The total loan amount for open-end credit plans is the total line of credit allowed under the plan. The Act makes clear that Ohio's anti-predatory lend-

ing law does not apply to purchase money loans or reverse mortgages. However, the Act amends the law to apply to open-end credit plans. The Act adds an additional prohibition to restrict the making of a covered loan if the consumer's gross debt-to-income ratio at the time of the consummation of the loan exceeds 50%, unless the consumer receives counseling and the lender provides a specific disclosure regarding the risks of entering into such a loan.

TITLE AGENTS

The Act requires title agents that handle an escrow in connection with a residential mortgage transaction not involving the issuance of title insurance to have coverage that protects the parties to the transaction against theft, misappropriation, fraud or any other failure properly to disburse settlement, closing or escrow funds. Title agents also must give buyers notice of the availability of owner's policies where such a policy has not been specified in connection with the closing of a purchase of residential real property. The Act also imposes additional requirements with respect to the issuance of insured closing protection letters.

CONCLUSION

SB 185 is comprehensive legislation designed to address consumer protection and abusive lending issues through regulating the residential mortgage loan process on a vast front covering many aspects of the origination and activities of service providers involved in that process. At this point, two things seem clear. First, state officials concluded that current law is insufficient to adequately protect consumers in light of perceived or actual abusive practices related to mortgage lending. Second, as other states undoubtedly are aware, and consumer advocates certainly are keenly aware, of the recent actions taken by the Ohio legislature. S.B. 185 may become a model anti-abusive lending measure for other states. ■

Comments Requested for Proposed Guidance on Nontraditional Mortgage Products

The Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR") recently announced their plans to issue guidance on nontraditional mortgage products. The guidance will primarily focus on residential mortgage underwriting and consumer protection. CSBS and AARMR intend to offer the guidance to state regulators with the expectation that the state regulators will adopt it for the use by state-licensed residential mortgage lenders and brokers.

The guidance will reportedly be based on the proposed federal Interagency Guidance on Nontraditional Mortgage Products, issued by the federal financial institution regulatory agencies in December of 2005. The proposed federal guidance addresses the heightened risk levels associated with nontraditional mortgage lending and the importance of carefully mitigating risk exposures. If adopted, the proposed federal guidance will only apply to depository institutions and their subsidiaries. To assist in the development of the guidance for state-licensed mortgage lenders and brokers, CSBS and AARMR are seeking comments on the proposed federal guidance.

In its own comments in support of the proposed federal guidance, CSBS points out that many nontraditional mortgage loans are increasingly being underwritten with less stringent or no income and asset verification requirements. CSBS further points out that the use of such less stringent requirements must be governed by clear policy guidelines coupled with other mitigating factors, such as lower loan-to-value and debt-to-income ratios and higher credit scores. CSBS states that, rather than being overly prescriptive in the qualification standards, it subscribes to lenders being individually responsible for determining the suitability of products, the qualification standards for customers, and the necessity for full and timely disclosures.

Institutions that offer nontraditional mortgage products are encouraged to review the proposed federal Interagency Guidance on Nontraditional Mortgage Products and to submit comments to CSBS and AARMR. Comments can be emailed to CSBS at Regs@csbs.org and are requested on or before August 14, 2006. A detailed report concerning the proposed federal Interagency Guidance on Nontraditional Mortgage Products can be found in the February 2006 issue of our Newsletter. ■

Tennessee Anti-predatory Lending Act Signed Into Law

The Tennessee legislature recently enacted the Tennessee Home Loan Protection Act (the "Act"). The provisions of the Act take effect on January 1, 2007. The enactment of this bill brings to twenty-six (26) the number of states (and D.C.) that will have anti-predatory lending laws that mimic the annual percentage rate ("APR") and points and fees triggers found in the federal Home Ownership and Equity Protection Act ("HOEPA"). Similar to other "HOEPA clones," the Act includes APR and points and fees triggers, prohibitions, assignee liability, provisions permitting the correction of bona fide errors, and penalty provisions. Each of these topics is discussed in more detail in the paragraphs below.

TRIGGERS

The Act applies to "high-cost home loans." A high-cost home loan is defined as a "home loan" which meets or exceeds a "rate threshold" and/or the "total points and fees threshold." A "home loan" means a loan in which: (i) the principal amount of the loan does not exceed \$350,000; (ii) the debt is incurred primarily for personal, family or household purposes; (iii) the loan is secured by a mortgage or deed of trust on real estate located in Tennessee upon which there is located or there is to be located a structure: (a) designed principally for occupancy by one-to-four families; and (b) that is or will be the primary residence of the borrower. A "home loan" does not include a purchase money loan, a reverse mortgage loan, a construction loan, a loan insured by the FHA or guaranteed by the VA, or an open end credit loan, unless the open end loan is structured to evade the provisions of the Act.

For purposes of the rate threshold,

the Act applies to loans considered a "mortgage" under HOEPA. HOEPA defines a mortgage as any loan where the annual percentage rate at consummation exceeds by more than eight percentage points (8%) for first lien mortgage loans and ten percentage points (10%) for subordinate lien mortgage loans the yield on Treasury securities with comparable periods of maturity.

With regard to the total points and fees threshold, the Act applies to loans where the total points and fees payable by the borrower at or before the loan closing exceed: (i) the greater of five percent (5%) of the total loan amount or two thousand four hundred dollars (\$2,400) if the total loan amount is more than thirty thousand dollars (\$30,000); or (ii) eight percent (8%) of the total loan amount if the total loan amount is thirty thousand dollars (\$30,000) or less. "Points and fees" include those items as defined under section 32 of the HOEPA regulations and the commentary thereto, both as amended from time to time.

"Points and fees" shall exclude, however, up to two (2) bona fide loan discount points (defined as those points that reduce the interest rate on the loan by at least 25 basis points for each discount point paid). "Points and fees" also shall not include so called "4(c)(7)" closing fees paid to an affiliate of the lender as long as the amount is reasonably consistent with amounts charged for comparable services by a party not affiliated with the lender at the time the loan is made.

PROHIBITIONS AND REQUIREMENTS

Similar to other state HOEPA-like law and HOEPA itself, the Act prohibits numerous practices in connection with high-cost home loans, including: (i) recommending or encouraging default on an existing loan in connection with the closing of a high-cost home loan that refinances the existing loan, (ii) assessing a fee to provide a release upon the prepay-

ment of a high-cost home loan, except for the actual cost paid to record the release, (iii) refinancing a home loan (including a high cost home loan) with a high cost home loan within 30 months of the prior loan without a net tangible benefit to the borrower, (iv) unless certain requirements applicable to insurance amounts and terms are met, financing any credit insurance product or debt cancellation or suspension agreement or contract, (v) consummating a high cost home loans unless the borrower has the ability to repay the loan; (vi) financing any points and fees in excess of an amount the greater of 3% of the total loan amount or \$1,500 if the total loan amount is more than \$30,000) or an amount equal to 5% of the total loan amount if the total loan amount is \$30,000 or less; (vii) assessing a borrower points and fees if the proceeds of the high-cost home loan are used to refinance an existing high-cost home loan with the same lender or affiliate of the lender; (ix) assessing prepayment fees that exceed in the aggregate two 2% of the loan amount prepaid in the first 24 months following the loan closing [prepayment fees or penalties cannot be charged to a borrower in a refinancing of a high-cost home loan when the lender or an affiliate of the lender is the note holder of the note being refinanced]; (x) making a high-cost home loans that contain a scheduled payment that is more than twice as large as the average of the earlier scheduled payments; (xi) making high-cost home loans that contain a payment schedule with regular periodic payments that cause the principal balance to increase; (xii) making a high-cost home loans with a provision that permits the lender, in its sole discretion, to accelerate the indebtedness, except this prohibition is inapplicable where the borrower defaults under the loan; (xiii) making a high-cost home loan with terms under which more than 2 periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to

the borrower; (xiv) providing for default rates of interest; (xv) assessing certain late payment fee practices; and, (xvi) presenting borrowers with a loan at closing with materially different terms from those disclosed on the last RESPA disclosures without re-disclosure not less than one (1) day before closing [materially different settlement charges mean the total settlement charges disclosed on the final settlement statement exceed such previously last disclosed settlement charges by an amount equal to more than 15% in the aggregate].

The Act also requires lenders making (or servicing, as applicable) high cost home loans to report at least quarterly both the favorable and unfavorable payment history information of the borrower on payments due to the lender on a high-cost home loan to a nationally recognized consumer credit reporting agency, and also to provide borrowers with: (i) a statutorily mandated written notice that advises borrowers to shop for other mortgages and that borrowers may be able to obtain a mortgage at a lower interest rate and fees from a competing lender; (ii) two pay-off statements within any 12 month period free of charge upon the request of the borrower [a reasonable fee may be charged for any additional requests for pay-off statements during any 12 month period]; (iii) disclosures that prominently display that the loan was made pursuant to the Act; and, (iv) in a separate document clearly identified, a notice of availability of counselors from third-party nonprofit organizations approved by HUD, a housing financing agency of Tennessee or the regulatory agency that has jurisdiction over the lender.

ASSIGNEE LIABILITY

Entities that purchase or are assigned a high-cost home loan will be subject to all claims and defenses with respect to the high-cost home loan that the borrower could assert against the lender of the high-cost

home loan. However, this liability does not apply when the purchaser or assignee demonstrates by a preponderance of the evidence that it exercised due diligence at the time of the purchase of the high-cost home loans or within a reasonable time thereafter intended to prevent it from purchasing or taking assignment of high-cost home loans.

The liability provisions of the Act also do not apply if a purchaser or assignee has exercised such due diligence by demonstrating that such purchaser or assignee: (i) has in place at the time of the purchase or assignment of the high-cost home loans policies that expressly prohibit the purchase or acceptance of assignment of any high-cost home loans containing such violations; (ii) requires, by the applicable purchase contract, that a seller or assignor of such loans to the purchaser or assignee represents and warrants to the purchaser or assignee as of the applicable sale date that either: (a) the seller or assignor will not sell or assign to the purchaser or assignee any high-cost home loan containing such violations; (b) the seller or assignor is a beneficiary of a representation and warranty from a previous seller or assignor to that effect, and, as a result of its purchase of the loans, the purchaser or assignee is a beneficiary of such representation and warranty; and (c) exercises reasonable due diligence at or before the time of the purchase or assignment of home loans, or within a reasonable period of time after the purchase or assignment of such home loans, that is intended by the purchaser or assignee to prevent the purchaser or assignee from purchasing or taking assignment of any high-cost home loan containing such violations.

The reasonable due diligence requirement referred to above may be met by employing lender's quality control sampling methodology and will not require loan-by-loan review.

CORRECTING BONA FIDE ERRORS

Lenders and servicers of high-cost home loans that fail to comply with

the provisions of the Act when acting in good faith will not be deemed to have violated such section if the lender or servicer establishes that either: (i) within thirty (30) days of discovery and prior to the institution of any action under the Act: (a) the borrower is notified of the compliance failure; (b) the lender or servicer has made appropriate restitution to the borrower; and (c) in connection with high-cost home loans made in violation of the provisions of the Act, the lender makes whatever adjustments are necessary to the loan to either, at the choice of the borrower, make the loan satisfy the requirements of the Act or change the terms of the loan in a manner beneficial to the borrower so that the loan will no longer be considered a high-cost home loan subject to the provisions of the Act.

The compliance failure must not be intentional and must have resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid such errors, and within sixty (60) days after the discovery of the compliance failure and prior to the institution of any action under this Act or the receipt of written notice of the compliance failure: (i) the borrower is notified of the compliance error; (ii) the lender has made appropriate restitution to the borrower; and (iii) in connection with high-cost home loans made in violation of the provisions of the Act, the lender makes whatever adjustments are necessary to the loan to either, at the choice of the borrower, make the loan satisfy the requirements of the Act or change the terms of the loan in a manner beneficial to the borrower so that the loan will no longer be considered a high-cost home loan subject to the provisions of the Act.

For purposes of these provisions, "appropriate restitution" means the reimbursement by the lender of any points and fees, interest, or other charges made by the lender and received from the borrower necessary to put the borrower in the same position as the borrower would have

been had the loan, as adjusted, been originally made.

Examples of a bona fide error include but are not limited to clerical, calculation, computer malfunction and programming, and printing errors.

PENALTY PROVISIONS

Any lender who makes a high-cost home loan in violation of the provisions of the Act is subject to the following: (i) actual damages; (ii) for willful or intentional violations, statutory damages equal to the amount of all finance charges and fees paid by the borrower and forfeiture of the remaining interest under the loan; and (iii) costs and reasonable fees for attorneys. Punitive damages may be awarded where a court finds that the violation is malicious or reckless, although they will be limited to three times the actual damages and the amount of all finance charges and fees paid by the borrower exclusive of costs and reasonable attorney's fees. Such actions must be brought within three (3) years from the date the borrower discovered or should have discovered the violation. Importantly, these remedies are not exclusive and are in addition to any other remedies available to a borrower under applicable law.

OTHER PROVISIONS

The Act also makes it unlawful to advertise in connection with a loan using the logo or name of another lender without that lender's express written consent. The Act contains an "intra-state" preemption provision that precludes Tennessee municipalities or political subdivisions from enacting and enforcing ordinances regulating financial and lending activities of entities regulated by the state or the federal banking agencies. Further, the Act states that it does not apply to the extent it is preempted by the National Bank Act, Homeowners' Loan Act, Federal Credit Union Act or regulations issued by agencies administering those laws or the FDIC. ■

Ninth Circuit Holds That California Per Diem Statutes Are Not Preempted

In late May, the United States Court of Appeals for the Ninth Circuit held that California's per diem loan interest statutes were not preempted by either the federal Depository Institutions Deregulation and Monetary Control Act ("DIDMCA") or the federal Alternative Mortgage Transaction Parity Act ("AMTPA"). This holding should not come as a surprise to followers of the Ninth Circuit's earlier decisions on DIDMCA and AMTPA preemption.

In *Quicken Loans, Inc. v. Wood*, the plaintiff residential mortgage lender challenged the defendant Commissioner of the California Department of Corporations' contention that it was violating various provisions of the California Financial and Civil Codes. Collectively, those provisions prohibit the charging of interest in excess of one day prior to recording the deed of trust. It was undisputed that the lender tolerated occasional delays between the disbursement of loan funds to the borrower and recording of the deed of trust. During those delays, the lender would assess interest on the disbursed loans.

The Commissioner initially sought to revoke the lender's residential mortgage lending license for failing to comply with California law. In response, the lender filed suit in the United States District Court for the Eastern District of California, moving thereafter for summary judgment against the Commissioner on the ground that both DIDMCA and AMTPA preempt the California per diem statutes. The Commissioner cross-moved for summary judgment as to those same issues. While the district court granted summary judgment in the lender's favor on the DIDMCA preemption claim, it granted summary judgment in the Commissioner's favor on the issue

of AMTPA preemption. (The lender also moved on the ground that the per diem statutes constituted an unlawful taking in violation of the Constitution's Takings Clause. Both the district court and the Ninth Circuit dismissed this claim for lack of ripeness.)

On appeal, the Ninth Circuit vacated the summary judgment in favor of the lender on the DIDMCA claim, and affirmed the summary judgment in the Commissioner's favor on the AMTPA claim. The appeals court quickly disposed of the DIDMCA argument, stating that it had previously held in the 2005 case of *Wells Fargo Bank, N.A. v. Boutris* that California's per diem statutes were not preempted by DIDMCA. The lender had argued that *Boutris* was not binding and should not be followed because the DIDMCA discussion in that opinion was dicta. The court disagreed, however, observing that the discussion in *Boutris* regarding DIDMCA opened with the statement that "we must decide this substantive preemption issue."

The Ninth Circuit next reached the AMTPA preemption issue. The court observed that various federal regulations permit federally chartered housing creditors to freely engage in alternative mortgage lending. The court found that Congress enacted AMTPA to eliminate the discriminatory impact that those regulations have on nonfederally chartered housing creditors. According to the court, AMTPA authorizes state housing creditors to make, purchase and enforce alternative mortgage transactions when those transactions are made in accordance with regulations issued by the Office of Thrift Supervision ("OTS"). Relying on AMTPA, the lender argued that the per diem statutes were preempted because: (1) they conflicted with an OTS regulation on loan payment and balance adjustments and (2) they destroy parity between federal and state housing creditors.

Regarding the adjustment regulation argument, the lender pointed to an OTS regulation that prohibits any

adjustments to the interest rate, payment, balance or term to maturity of an alternative mortgage transaction unless the adjustment is made in accordance with the regulation. Citing this regulation, the lender argued that when recording occurs more than a day after fund disbursement, the state law requires adjustments in the payment amount based on the arbitrary date of the late recording. The lender contended that this factor was not permitted by the OTS regulation and, thus, California and federal law conflicted. The Ninth Circuit characterized this argument as “a conflict argument invoking physical impossibility.” It rejected the argument, however, stating “there is no actual conflict between the California per diem statutes and the OTS regulation on adjustments. It is not physically impossible to charge no interest for more than one day before recording and to adjust payments only in accordance with the OTS regulation’s requirements.”

The lender argued in the alternative that because the per diem statutes do not apply to federally chartered housing creditors as they do to state housing creditors, AMTPA preemption is necessary to achieve parity. Relying in part on its 2003 decision in *Ansley v. Ameriquest Mortgage Co.*, and on a 2001 decision by the California Court of Appeals in *Black v. Financial Freedom Senior Funding Corp.*, the Ninth Circuit rejected this alternative argument, holding that the scope of preemption is limited to the extent of the regulations designated by the OTS or in the case of a state law that directly prohibits the making of alternative mortgage transactions. The court found that the per diem statutes do not “tread on” an area of federal regulation which the OTS has identified as applicable to state housing creditors and, further, the per diem statutes do not prohibit the making of alternative mortgage transactions. The court also found that the per diem statutes “do not touch upon the areas identified by the OTS as essential and intrinsic to the ability to engage

in alternative mortgage transactions.” The Ninth Circuit concluded, therefore, that because “the California per diem statutes do not conflict with OTS regulations applicable to non-federally chartered housing creditors; do not prohibit making, purchasing, or enforcing alternative mortgage transactions; and do not inhibit the making, purchasing, or enforcing of alternative mortgage transactions per se, they are not preempted by the Parity Act.”

The Ninth Circuit includes the states of California, Alaska, Hawaii, Washington, Oregon, Idaho, Montana, Nevada and Arizona. ■

Another Federal District Court Weighs In on Firm Offers

In a recent decision, the Central District of California held that in order for a communication to constitute a “firm offer of credit” under the Fair Credit Reporting Act (“FCRA”), it must contain “some range of interest rates, method of computation, and/or other useful information regarding the financing.” In a June 6, 2006 order, the Court denied the defendant’s motion to dismiss in *Rhonda L. Torres v. People’s Choice Home Loan, Inc.*, rejecting arguments raised by People’s Choice that it could have no liability under the FCRA because the solicitations it sent to the plaintiff were “firm offers of credit,” a permissible use of credit information obtained from a reporting agency.

In *Torres*, the plaintiff received a document in the mail from People’s Choice, informing her that she had been “pre-approved” for a loan. The document also stated that the offer was contingent on meeting the criteria for the offered loan program and, subject to certain caveats, that the minimum loan amount available in connection with the offer was \$50,000 and the maximum was \$1,000,000. The plaintiff brought this putative class action, alleging that People’s Choice obtained

consumer reports, including hers, for an unlawful purpose in violation of the FCRA, because the solicitation People’s Choice sent out was not a “firm offer of credit” under the statute. Specifically, the plaintiff alleged that the solicitation failed to state the “essential terms” of the transaction, such as the “amount of credit to be extended and the rate of interest charged.” Without such terms, the plaintiff argued that the solicitation is nothing more than a “sales pitch” to get customers to apply for a loan.

Although the *Torres* Court recognized that a firm offer of credit may be conditional on meeting certain criteria, it held that an offer must contain particular information about credit terms and endorsed the Seventh Circuit’s holding in *Cole v. U.S. Capital, Inc.* that “a communication must set forth sufficient terms to make it a legitimate credit product and to have value to the consumer.” In adopting this position, the Court rejected a contrary holding by the Northern District of California in *Putkowski v. Irwin Home Equity Corp.*, which refused to impose the “value to the consumer” requirement.

In denying the Motion to Dismiss, the Court stated that, as written, the solicitation sent by People’s Choice was nothing more than an advertisement and contained “insufficient information to be of value to the consumer,” because it contained no minimum or maximum interest rate, no method of computing the rate, and only “an incredibly wide range” of possible loan amounts, from \$50,000 to \$1,000,000. The Court summarized its holding: “While the FCRA does not require exact terms or an unconditional offer, a firm offer of credit must give some range of interest rates, method of computation, and/or other useful information regarding the financing.” Although the Court recognized that the precise terms of the offer need not be identified, it did not elaborate on what “other useful information” might be sufficient or would provide “value” to the consumer. ■

States Licensing Update

COLORADO – New Licensing Requirements for Mortgage Brokers

On or after January 1, 2007, Colorado law will require the registration of mortgage brokers under the Colorado Mortgage Broker Registration Act (the "Act"). Under the Act, a mortgage broker includes any individual who, for compensation, negotiates, originates, or offers or attempts to negotiate or originate a loan to be consummated and funded by a mortgage lender. Individuals acting in the capacity of a Mortgage Broker will be required to register and, in connection with that registration, must provide an active surety bond and submit to a criminal background investigation. Among others, those exempt from registration include certain financial institutions, wholesale lenders, and Federal Housing Administration-approved mortgagees or Federal Housing Administration-approved loan correspondents.

IDAHO – Continuing Education Requirements

Effective March 30, 2006, Idaho adopted administrative regulations establishing continuing education requirements. Licensed Idaho loan originators and branch managers of licensed locations must complete 16 hours of approved continuing education courses during each two-year reporting period. The initial two-year reporting period for individuals presently registered with the Idaho Department of Finance commences on November 1, 2006.

IOWA – Adoption of Mortgage Banker Regulations

Effective July 1, 2006, Iowa adopted administrative regulations implementing the statutory provisions pertaining to Iowa Mortgage Bankers and Brokers. Licensees now must file an annual report on or before April 15 of each year. The regulations also clarify that Iowa's continuing education year begins on May 1 and ends on April 30 and that any individual registered as of December 31 must complete 12 hours of approved continuing education prior to April 30 of the following year. Licensees also are required to meet certain recordkeeping requirements including, among others, maintaining certain records for at least 25 months from the date of the final transaction involving the borrower.

KENTUCKY – License Exemption Update

As reported in our June 2006 edition of Mortgage Finance Newsletter, Kentucky has amended its statutory requirements to narrow the exemption from Mortgage Loan Company and Loan Broker licensing available to FHA-approved entities. The Kentucky Office of Financial Institutions has issued guidance on its website regarding its implementation of the recent statutory changes. Specifically, entities that enjoy an exemption from licensing in Kentucky pursuant to their FHA approval, including lenders, brokers, and branches of such entities, must apply for licensure not later than February 15, 2007 if such entity does not fund or broker at least 12 FHA-insured residential mortgage loans secured by Kentucky real property during 2006. Until February 15, 2007, existing exempt entities may continue to rely on the exemption from licensing available to FHA-approved entities even if they do not expect to make or broker 12 FHA-insured residential mortgage loans secured by Kentucky real property during 2006.

MISSISSIPPI – Amended Mortgage Company Regulations

Effective July 1, 2006, changes to Mississippi regulations require that Mortgage Company Licensees and Registrants comply with additional significant event reporting requirements. Among others, Mortgage Company Licensees and Registrants must provide written notice to the Department of Banking and Consumer Finance regarding a loan originator's termination of employment within 30 days of that date. In addition, Mortgage Company Licensees and Registrants are now required to maintain a log at their principal licensed location. That log must include certain information, including the name of the applicant and co-applicant, date of application, and the disposition of the loan application, including the date of loan funding, loan denial, withdrawal, and, if applicable, the name of the lender. The regulations also now provide that each licensed branch location must have at least one licensed loan originator working at that location. The regulations also provide certain guidelines regarding license posting obligations for licensees, registrants, and loan originators.

impose notification requirements on mortgage lenders and brokers following significant events, restrict the use of the word "pre-approval" and make some modifications to the existing regulations with respect to lock-in agreements and third party fees.

ADVERTISING REGULATIONS

Under the new regulations, every advertisement published by or on behalf of a licensed mortgage lender or broker must clearly and conspicuously disclose: (1) the name of the lender or broker, as it appears on its Virginia license; (2) a statement that the lender or broker is licensed by the "Virginia State Corporation Commission;" (3) the lender or broker's Virginia license

number; (4) if the advertisement contains a rate of interest, a statement that the rate may change or not be available at the time of loan commitment or lock-in; and (5) if the advertisement contains specific information that was not obtained from the consumer about the consumer's existing loan, a statement identifying the source of the information. If the advertisement states or implies that refinancing will reduce the consumer's currently monthly payment, but a refinancing will result in an increase in the consumer's total finance charges over the life of the loan, the fact that the finance charges may be higher over the life of the loan must be clearly and conspicuously disclosed.

The advertisement may not contain false or misleading statements or rep-

resentations and may not state or imply that the mortgage lender or broker is affiliated with, or an agent or division of, a governmental agency, depository institution or other entity with which no such relationship exists. Additionally, the advertisement may not state or imply that the consumer has been or will be preapproved for a loan unless the face of the advertisement contains a statement in 14-point bold type that "THIS IS NOT A LOAN APPROVAL." Interestingly, the regulation states that this provision is intended to supplement the requirements under the Fair Credit Reporting Act ("FCRA") relating to firm offers of credit. Given the broad preemption provisions of the FCRA, it is unclear whether this requirement is enforceable in connection with firm offers of credit.

The face of the advertisement must also contain a clear and conspicuous disclosure of the conditions and/or qualifications associated with the preapproval. Mortgage lenders and brokers may not distribute advertisements or written materials that give a false impression that the material is being sent by the consumer's current noteholder or that it is an official communication from a governmental agency. Lenders and brokers must retain all advertisements, including solicitation letters, commercial scripts and recordings of radio and television broadcasts, for at least three years after the advertisement is last transmitted or made available.

SIGNIFICANT EVENTS NOTIFICATION

The new regulations require licensed mortgage lenders and brokers to file written notification with the Commissioner of Financial Institutions within 15 days of becoming aware of certain occurrences. The occurrences include: (1) bankruptcy filing; (2) license suspension or revocation; (3) governmental regulatory or enforcement action or being required to pay restitution or other payments in excess of \$20,000 (unless disclosure is prohibited by another state's laws); (4) entering into a consent decree or settlement

Oklahoma Restricts Mortgage Lender Advertising

Oklahoma has joined the ranks of states that are more closely regulating the advertising activities of mortgage lenders (see companion Virginia article). Beginning July 1, 2006, Oklahoma will prohibit the use of the name, trade name or trademark of a lender (or a name, trade name or trademark similar to a lender's) without the lender's prior consent unless certain disclosures are given. "Lender" is defined to include a bank, savings and loan association, savings bank, credit union, finance company, mortgage bank, mortgage broker and any affiliate.

No advertisement may include a loan number, loan amount or specific loan information that it is not publicly available. An advertiser may use loan information that is publicly available provided that certain disclosures are given. The advertiser must obtain written consent from a borrower's existing lender before referencing that lender in an advertisement. There are additional restrictions with respect to providing specific loan information on a post card or visible on the outside of an envelope containing the advertisement.

Lenders who provide advertisements to current customers or individuals who were customers of the lender during the preceding eighteen months are exempt from the advertising restrictions. Also exempt are advertisements that compare the products and services of the advertiser with another lender, provided the advertiser clearly and conspicuously identifies itself in the advertisement. ■

with a government authority based on allegations that the licensee has violated laws or regulations related to the mortgage business; (5) license surrender in another state in lieu of threatened or pending license revocation or suspension, or other regulatory enforcement action; (6) mortgage license denial in another state; and (7) felony indictment or conviction of the licensee or any of its employees, officers, directors or principals.

ADDITIONAL CHANGES

Licensed mortgage lenders and brokers may not inform a consumer that he or she has been preapproved unless the licensee simultaneously

provides certain disclosures. Specifically, the disclosure, which must be in at least 10-point type, must provide: (1) an explanation of what preapproval means; (2) a statement that the consumer's loan application has not yet been approved; (3) a statement that a written commitment to make a mortgage loan has not yet been issued; and (4) a statement of what needs to occur before the consumer's loan application can be approved. Additionally, if a licensee communicates a preapproval to the borrower by telephone, the licensee must provide the written disclosure to the consumer within three business days. The preapproval disclosure requirement does not apply to adver-

tisements, as discussed above.

Mortgage lenders and brokers must sign the lock-in agreements they issue. A mortgage broker may not issue a lock-in agreement to a consumer unless the broker has actually locked in the mortgage loan, including the interest rate, points and other terms, with a mortgage lender. Brokers must maintain written documentation from mortgage lenders on all lock-in information for at least three years from the lock-in expiration date.

Under the new regulations, mortgage lender and broker licensees are explicitly prohibited from retaining any portion of fees or charges imposed on consumers for third party goods or services. ■

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James C. Clarke, Jr., Licensing Specialist
Emmanuel P. Cruz, Licensing Specialist
Melissa M. Jewett, Licensing Specialist

(202) 628-2000

www.wbsk.com

info@wbsk.com