LENDERS UPDATE™

A MONTHLY SERVICE TO THE MORTGAGE LENDING INDUSTRY

AN ALT & ASSOCIATES NEWSLETTER

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FRB ANNOUNCES NEW RULES FOR LOAN ORIGINATOR COMPENSATION

Just when things are a bit quiet, another shoe (how many can there be?) hits the floor.

Today, August 16, 2010, the Federal Reserve Board ("FRB") announced new loan originator compensation practices, which will apply to loan brokers and loan officers. The rules will take effect on April 1, 2011.

Under the new rule, a loan originator may not receive compensation that is based on interest rate or other loan terms. This is to prevent loan originators from increasing their compensation by increasing interest rates or points. In the words of the FRB, this is a "common practice".

Further, if the loan originator receives compensation directly from the consumer, the originator cannot also receive compensation from another source or from the lender.

Finally, the loan originator cannot direct or "steer" a consumer to a mortgage loan that is not in the borrower's interest.

These rules are very similar to those recently enacted as legislation in the Dodd-Frank legislation we discussed in our July Lenders Update , available on our website at www.altandassociates.com .

In the next couple of days, when we have had a chance to review the entire rule (113 pages), we will give you a more detailed summary.

FORENSIC AUDITS AND THE TRUTH IN LENDING ACT

The mortgage lending industry seems to go through evolutionary trends. As an example, at the beginning of the mortgage lending crisis, loan modifications and loan modification companies were all the rage. However, because of overreaching and the outright fraud of a number of these companies, regulatory agencies stepped in and by and large, as witnessed in California, have shut these companies down. This includes "modifiers' who tried to team up with attorneys to do what they otherwise could not. In California, a large number of attorneys have also been disciplined for participation in these activities.

Following that, we seem to be to now be in period of "forensic audits". The basic transaction is that a borrower goes to a law firm to stop an imminent foreclosure. The law firm hires an "expert" witness which performs a forensic review of the loan. These persons or companies review the loan file and determine areas in which the loan may be in violation of applicable law or

regulation. The forensic reports are then turned over to the law firm where they used as the basis for a law suit, usually, in our experience, to forestall the pending foreclosure action. Obviously the quality of the forensic review varies depending on the experience and quality of the reviewing entity. Some that we have seen are reasonably good and accurate. Some, however, are downright horrible.

Again, in our experience, the most frequent findings in these reviews are violations of the Truth in Lending Act ("TILA"). We thought it might be interesting, over the next several months while the legislation/regulation cycle may be relatively quiet for elections, to look at some of the issues being raised.

<u>Time window for law suits based on a failure of a lender to rescind after notice</u>

A frequent theme involves when the right of rescission period expires and perhaps more significantly, when an action can be brought to enforce the rescission and/or recover damages. As we know, at closing, consumers are given a 3-day day period to rescind the transaction. If the "Notice of the Right to Rescind" is faulty or there are faulty disclosures, the right to rescind is extended and will not expire until 3 years after the closing. If, within the 3 year period, the borrower notifies the lender or its assignee/servicer of a rescission and the obligation is not rescinded, the issue becomes, when can the borrower bring an action to enforce its rights or claims?

The recent case of Sherzer vs. Homestar Mortgage Services, Civil Action No. 07-5040 (E.D. Pa., May 7, 2010) reviews this question. The court found that if the consumer gives a proper notice of rescission within the extended 3 year period, the consumer may commence a suit to enforce rescission during or after the 3 year period. But, is there an outside time limit in which the action must be filed after the borrower provides the "Notice of Rescission"?

The court states that the Truth in Lending Act and Reg. Z require a borrower to provide a notice of rescission to a lender within the initial 3-day period, or if there is a deficiency in the required lender notice or disclosures during the extended 3 year period. However the borrower is not required to bring an action to enforce this rescission, in order for it to be effective. The actual rescission is effective immediately upon notice, barring any other factors.

However, the court found that the borrower must bring an action to enforce its rescission notice within 1 year of the lender's failure to properly respond to the consumer's notice of rescission, whether that falls within the initial 3 year period or after it has expired. The borrower must sue to enforce rescission within 1 year of the violation resulting from the creditor's failure to properly respond to its notice of rescission with the required 20 day period.

This holding is particularly applicable to many of the law suits we have seen brought against lenders and their assignees and servicers resulting from loans made in 2005, 2006 and 2007. Most include claims that the initial notice of rescission was faulty and/or that the initial disclosures were in some way wrong or defective. As a result, the 3-day notice of right to rescind period, is

extended to 3 years. The borrower then provides notice of rescission sometime during this 3-year period. The Sherzer ruling stands for the proposition that a law suit has to be filed within one year plus 20 days, of the borrower sending the notice of rescission.

Effect of foreclosure on the time periods

Next time we will discuss the effect the commencement of foreclosure on the time periods during which a borrower can rescind.

FHA HEADS UP

During the past two months, the FHA has issued several Mortgagee Letters, three of which are of particular interest. All of these Mortgagee Letters can be found on the HUD website at www.hud.gov under "Resources" by clicking "Mortgagee Letters". We suggest that if our brief summary seems applicable to you, that you review the Mortgagee Letters in full.

Mortgagee Letter 2010-20

This Mortgage Letter 10-20 was issued on June 11, 2010 and is almost old news by now. However, it does provide an overview of, and additional amplification of HUD's new regulations, discussed in detail in our April Lenders Update available on our website at www.altandassociates.com.

ML 10-20 discusses the new net worth requirements and their phase-in for both new applicants and currently approved lenders.

It reviews the elimination of loan correspondent approvals for single family programs. As we know, loan correspondents approved and in good standing will be permitted to retain their approval through December 31, 2010. However, on May 20, 2010 the FHA stopped accepting new applications for loan correspondents. Correspondents from that date forward, and for presently approved correspondents after December 31, 2010, will be treated as third party originators ("TPOs") and will not be approved by HUD.

The Letter discusses mortgage origination activities, providing new information and guidance in the process.

The Mortgagee Letter also discusses principal/agent relationships. These will now only be entered into by two FHA approved mortgagees both of which possess unconditional DE approvals.

This Mortgagee Letter should be required reading for any FHA lender, Correspondent or TPO.

<u>Mortgagee Letter 2010-23</u>

On August 6th HUD issued Mortgagee Letter 2010-23 which deals with HUD's enhancements to the existing Making Homes Affordable Program and Federal Housing Administration and Refinance Program. HUD's stated purpose in making the enhancements is to provide continued home ownership by providing borrowers who may owe more on their mortgage than the value of their homes, the opportunity to refinance into an affordable FHA loan. The

Letter discusses effective dates, eligibility, underwriting requirements, current mortgage requirements, acceptable credit history and loan to value ratios and many other aspects of the program.

Mortgagee Letter 2010-24

Also on August 6th, HUD released Mortgage Letter 2010-24. This letter eliminates the unlimited Combined Loan to Value ratio ("CLTV") that was first introduced in Mortgagee Letter 07-11. With the exception of streamline refinance transactions, the combined amount of the FHA first mortgage and any subordinate lien, may not exceed the applicable FHA loan to value ratio and the geographical maximum mortgage amount. This applies to case numbers assigned on or after September 7th of this year. A chart is provided, showing maximum CLTV for refinance transactions.