LENDERS UPDATE™

A MONTHLY SERVICE TO THE MORTGAGE LENDING INDUSTRY

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The purpose of the Lenders Update is to provide a "heads-up" of new legislation and regulations affecting the mortgage lending industry. We try to provide brief summaries of new matters so our readers can judge whether the subject impacts their operations. We recommend that our readers review the entire new material in detail where relevant. For your convenience, the applicable statute, regulation or cases can be easily identified in the summary. Our Update includes changes in legislation available to Alt & Associates by August 15, 2005

STATE ISSUES

MASSACHUSETTS

House Bill 5195 became law on **August 2, 2006**. Generally, the new statute prohibits the use of any name (trade name or trademark among others) of any bank, federal bank, federal branch, foreign bank, or federal credit union, in any advertisement or solicitation for products or services, without the express written consent of the financial institution. It also prohibits the use of any reference to a loan number, loan amount or other specific loan information, on the outside of an envelope, visible through the envelope window or, on a postcard in connection with any written solicitation. If this information is used in a permissible fashion and is publicly available, the advertisement must clearly and conspicuously state in bold face type on the front page of the correspondence, that the person using this information is not sponsored by, or affiliated with, the financial institution. Among other sanctions, damages may be assessed in the amount of up to $10,000.00 per violation or the amount of actual damages, whichever is greater.

OKLAHOMA

In our previous Lenders Update, we reported amendments to Oklahoma Department of Consumer Credit rules 160:55-11-1.1 to 1.3 relating to the disclosure of fees and the proper disclosure of yield-spread premiums. We reported these rules as effective based on the Oklahoma Department of Consumer Credit website. However, it has come to our attention that these rules have not been promulgated and are not effective. We apologize for any inconvenience.

OHIO

On June 19, 2006, Ohio passed new legislation which, among other changes, modifies the Consumer Sales Practices Act and Consumer Mortgage Loan Law. The provisions of SB 185 will become effective **January 1, 2007**. The new laws apply to non-bank mortgage lenders and brokers that are licensed under the Ohio Mortgage Loan Act. The changes are extensive but below you will find our effort to summarize the most pertinent.

INCREASED ENFORCEMENT

SB 185 provides the Attorney General and local prosecutors with enforcement authority for violations of the Second Home Mortgage Act, Mortgage Loan Act and Predatory Lending Act. Previously, enforcement was done only by the Department of Commerce, Division of Financial Institutions.

SECOND MORTGAGE LOAN ACT

SB 185 modifies the Second Mortgage Loan Act by changing the years and amount of prepayment penalty that may be charged. A prepayment penalty provision is allowed the first two years after the date of consummation of the loan documents. The prepayment penalty shall 1) not exceed 2% of the original principal amount of the loan if the loan is paid in full prior to the one year date following the execution of the loan documents and 2) 1% if the loan is paid in full from one year, but prior to two years after the loan contract is executed.

MORTGAGE LOAN ACT

Enhanced Licensing Requirements

SB 185 increases the licensing requirements for those seeking a license under the Mortgage Brokers Act. Some of the new requirements are as follows:

- Appraisers must now be licensed.
- National Background checks are now required for mortgage brokers, loan officers and appraisers.
- Mortgage Brokers and Loan Officers are required to complete 24 hours of continuing education in various categories.
- SB 185 also requires an applicant to successfully pass a licensing examination prior to obtaining a license.
- There is no longer a 90-day provisional period in which an applicant may make loans prior to the passing of the exam;

Increased Disclosures

SB 185 has amended and increased the amount of disclosures required on the Mortgage Loan Origination Disclosure Statement ("MLODS"):

- If the loan applied for will exceed 90% of the value of the home, a statement must be provided in boldface type, 16 sized font stating: "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 MLODS must now be acknowledged and signed by the borrower;
- If there is any change in the information provided, the licensee must provide the borrower with the revised MLODS and a written explanation of why the change

occurred. Such written explanation must be provided no later than 24 hours after the change occurs or 24 hours before the loan closes, whichever is earlier;

- The licensee must deliver to the buyer, immediately upon receipt, a copy of the borrower's credit score and report obtained for the purpose of the mortgage loan application;
- If an automated valuation model is used to determine an appraisal report, the licensee must also include a copy of that report;
- The licensee must deliver the MLODS and Good Faith Estimate ("GFE") at the same time. On the GFE, an underlined notice in at least 10 point type, new roman style must be provided that states:

"NATURE OF RELATIONSHIP: IN CONNECTION WITH THIS RESIDENTIAL MORTGAGE LOAN, YOU THE BORROWER(S), HAS/HAVE REQUESTED ASSISTANCE FROM … (COMPANY NAME) IN ARRANGING CREDIT. WE DO NOT DISTRIBUTE ALL PRODUCTS IN THE MARKET PLACE AND CANNOT GUARANTEE THE LOWEST RATE.

TERMINATION: THIS AGREEMENT WILL CONTINUE UNTIL ONE OF THE FOLLOWING EVENTS OCCUR:

1. THE LOAN CLOSES.
2. THE REQUEST IS DENIED.
3. THE BORROWER WITHDRAWS THE REQUEST.
4. THE BORROWER DECIDES TO USE ANOTHER SOURCE FOR ORIGINATION.
5. THE BORROWER IS PROVIDED A REVISED GOOD FAITH ESTIMATE STATEMENT.

NOTICE TO BORROWER(S): SIGNING THIS DOCUMENT DOES NOT OBLIGATE YOU TO OBTAIN A MORTGAGE LOAN THROUGH THIS MORTGAGE ORIGINATOR NOR IS THIS A LOAN COMMITMENT OR AN APPROVAL; NOR IS YOUR INTEREST RATE LOCKED AT THIS TIME UNLESS OTHERWISE DISCLOSED ON A SEPARATE RATE LOCK DISCLOSURE FORM. DO NOT SIGN THIS DOCUMENT UNTIL YOU HAVE READ AND UNDERSTOOD THE INFORMATION IN IT. YOU WILL RECEIVE A RE-DISCLOSURE OF ANY INCREASE IN INTEREST RATE OR IT THE TOTAL SUM OF DISCLOSED SETTLEMENT/CLOSING COSTS INCREASES BY 10% OR MORE OF THE ORIGINAL ESTIMATE. SHOULD ANY INCREASE OCCUR; MANDATORY RE-DISCLOSURE MUST OCCUR PRIOR TO THE SETTLEMENT OR CLOSE OF ESCROW."

Disclosures Concerning Escrow

SB 185 has also included an entire subsection dedicated to disclosures concerning escrow of property taxes and description of items covered in monthly payments. Not later than 24 hours before the loan is closed, a licensee must deliver to the buyer a written disclosure that includes the following:

- A statement indicating whether property taxes will be escrowed;

- A description of what is covered by the regular monthly payment, including principal, interest, taxes and insurance, as applicable.

List of Prohibitions Concerning Material Changes in Loan Terms

No licensee shall fail to do either of the following:

- Timely inform the borrower of any material change in the terms of the loan;
- Timely inform the borrower if any fees payable by the borrower to the licensee increased by more than 10% or $100 whichever is greater.

List of Prohibitions for Mortgage Brokers, Registrants, Licensees, etc

Further, SB 185 adds to the list prohibitions for mortgage brokers, registrants, licensees, or applicants for a certificate of registration or license any of the following:

- Knowingly compensate, instruct, induce, coerce or intimidate a licensed or certified appraiser;
- Promise to refinance a loan in the future at a lower interest rate or with more favorable terms unless the promise is made in writing and initialed by the borrower.

Disclosures Regarding Settlement Services or Title Insurance

Moreover, SB 185 requires a licensee to provide a written disclosure if a referral is made to a settlement service provider or title insurance company. The following must be included in the disclosure:

- Any business relationship that exists, including any financial benefit that may be given to the licensee because of the relationship;
- The percentage of ownership interest the licensee may have in the provider;
- The estimated charge or range of charges for the settlement service;
- The following statement, printed in boldface type, 16 point font:

"THERE ARE FREQUENTLY OTHER SETTLEMENT SERVICE PROVIDERS AVAILABLE WITH SIMILAR SERVICES. YOU ARE FREE TO SHOP AROUND TO DETERMINE THAT YOU ARE RECEIVING THE BEST SERVICES AND THE BEST RATE FOR THESE SERVICES."

Referral to an Appraisal Company

SB 185 outright prohibits a referral to an appraisal company if the licensee or the licensee's immediate family has either of the following financial relationships with the appraisal company: 1) ownership or investment interest or 2) any compensation arrangement involving any remuneration, directly or indirectly, in cash or in kind.

The above written disclosures must be kept for 4 years.

Fiduciary Duties of Mortgage Broker or Loan Officers

SB 185 requires licensees to safeguard and account for any money handled for the borrower, follow reasonable and lawful instructions from the borrower, act with reasonable skill, care and diligence and make reasonable efforts to secure a mortgage loan with lenders with whom the registrant, licensee or person regularly does business, to secure a loan with rates, charges and repayment terms that are advantageous to the borrower.

In other words, licensees have a fiduciary duty to borrowers and must act in the best financial interest of the borrower. Violation of this duty may carry punitive damages.

However, this duty does not apply to wholesale lenders. Wholesale lenders are exempt from this duty but must meet the standard of care applicable to lenders. (See Predatory Lending Act section).

PREPAYMENT PENALTIES

SB 185 now prohibits mortgage brokers, non-bank mortgage lenders and loan officers from charging a prepayment penalty on first mortgage loans less than $75,000. This amount will be adjusted annually based on the consumer price index. On loans greater than $75,000, prepayment penalties can be charged at 1% for the first five years.

CONSUMER SALES PRACTICES ACT

Mortgage brokers and loan officers must now comply with the Consumer Sales Practices Act. Previously, there was an exemption for mortgage lending in the Consumer Sales Practices Act. The Consumer Sales Practices Act is Ohio's consumer protection statute and it generally prohibits all acts that the Attorney General or a court, find to be unfair, deceptive or unconscionable.

Unconscionable Acts

SB 185 puts into place 16 specific mortgage lending activities and practices that it considers unconscionable:

1. Making a mortgage loan with a provision that provides for a higher interest rate after default excluding rates for judgments or rate changes in variable rate loan transactions.
2. Providing a mortgage loan based on the foreclosure or liquidation value of the borrower's property without regard to the borrower's ability to repay the loan in accordance to the terms of the loan.
3. Making a mortgage loan that permits the lender to demand repayment of the outstanding balance of a mortgage loan in advance of the original maturity date, unless the lender does so in good faith due to the borrower's failure to abide by the material terms of the loan.
4. Knowingly replacing, refinancing, or consolidating a zero interest rate or other low-rate mortgage loan made by a government or non-profit lender with another loan. An exemption exists if the current holder of the loan consents in writing to the refinancing and the borrower presents written certification from a 3rd party nonprofit organization counselor approved by HUD or the Superintendent of Financial Institutions that the borrower received counseling on the advisability of the loan transaction.
5. Instructing borrower to ignore the supplier's written information regarding the interest rate and dollar value of points because they would be lower for the borrower's consumer transaction.
6. Recommending or encouraging a consumer to default on a mortgage or any consumer transaction or revolving credit loan agreement.

7. Charging a late fee more than once with respect to a single late payment.
8. Failing to disclose to the borrower at the time of closing that the borrower is not required to complete the transaction merely because the borrower has received prior estimates of closing costs or signed an application and should not close a loan transaction that contains different terms and conditions than those the borrower was promised.
9. Making a mortgage loan that includes terms under which more than two payments required are consolidated and paid in advance from the loan proceeds;
10. Knowingly compensating, instructing, inducing, coercing or intimidating an appraiser for the purposes of influencing their judgment with respect to the value of the dwelling used as security.
11. Financing, directly or indirectly, and credit, life, disability or unemployment insurance premiums, or any debt collection agreement.
12. Knowingly or intentionally engaging in the act of flipping a mortgage loan. Flipping is defined as the refinancing of the existing home loan when the new loan does not have reasonable, tangible net benefit to the borrower. This provision applies regardless of whether the interest rate, points, fees and charges paid or payable by the consumer in connection with the refinancing exceed any thresholds specified in any section of the revised code.
13. Knowingly taking advantage of the inability of the borrower to reasonably protect the borrower's interest because of a known physical or mental infirmity or illiteracy.
14. Entering into a loan transaction knowing there was no reasonable probability of payment of the obligation by the borrower.
15. Attempting to enforce, by means not limited to a court action, a prepayment penalty in violation of Division (C)(2) of section 1343.011 (see below).
16. Engaging in an act or practice deemed unconscionable by the rules adopted by the Attorney General. The Attorney General has not, as of this date, promulgated any administrative rules.

Generally, any violation of the above 16 prohibited acts would allow a borrower to rescind the transaction or recover damages. However, SB 185 has also included a provision that limits rescission on residential mortgage transactions to be allowed only upon an individual action (no class actions) and only on Truth in Lending violations.

In addition to the above 16 unconscionable acts, unconscionable arbitration clauses, attorneys' fees clauses and liquidated damages clauses in contracts are prohibited.

PREDATORY LENDING ACT

SB 185 also makes some significant amendments to the Ohio Predatory Lending Laws. A covered loan is defined as a consumer credit mortgage loan transaction, which now includes open-end credit plans that are secured by the borrower's principal dwelling and which in the terms of the loan meet or exceed one or more of the two thresholds:

- APR at consummation of the transaction exceeds the amount established Regulation Z; or
- If the total loan amount is $25,000 or more, the total points and fees payable by the consumer at or before loan closing exceed 5% of the total loan amount; or 8% if the total loan amount on the loan is less than $25,000.

- Points and Fees have the same meaning as HOEPA and include 1) single premium credit insurance and 2) all compensation paid directly or indirectly to a mortgage broker from any source. If an Open-ended credit plan, Points and Fees includes fees paid for the ability to access the line of credit and fees paid in order to utilize the maximum amount of credit available.
- Points and Fees do not include:
    - Fees paid to a Federal or State government agency that insures payment of some portion of a home loan;
    - An amount not to exceed 1 percentage point in indirect mortgage broker compensation paid by any source.

Making a Covered Loan

SB 185 also added an additional prohibition on making a covered loan, if at the time the loan was consummated, the borrower's total monthly debt, including amounts owed under the loan, exceed 50% of the borrower's monthly gross income. A covered loan may be made if the borrower submits both of the following:

- Verification that the borrower received pre-purchase counseling from a counseling service that meets the criteria as set by the Superintendent of Financial Institutions; and
- A disclosure, signed by the consumer acknowledging the risk of entering into such a loan.