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, cases or website can be easily identified in the summary. Our Update includes information available to Alt & Associates by October 19, 2007

Repurchase Indemnity/Demands…some thoughts and considerations.

For more than the last 15 years, Alt & Associates has represented Mortgage Bankers or Brokers of all sizes. During this period, our services have often included prosecution or defense of demands for repurchase of loans or indemnity claims resulting from the breach, by an originating lender or broker, of its representations and warranties. Thankfully, these activities were somewhat infrequent.

Unfortunately, this is no longer the case. For years, the Loan Purchase Agreement or Broker Agreement has been steadily evolving, transferring more and more of the loan risk to the originating lender or broker. The traditional representations and warranties have changed from areas within the control of the party making these promises, to areas totally beyond their control. These new types of representations include, payment default provisions (1st payment, 90 day or otherwise), warranties of the absolute truth of all information provided by or about the borrower, and warranties by brokers that all loan documentation or underwriting is correct (this is true even in situations where the documentation or underwriting is not performed by the broker). Representations or warranties of this nature are generally beyond the control of the party making them and transfer risk to the party who has the least bargaining power.

Beyond this, as an obvious effect of the credit upheaval of the last 6 to 12 months, the big boys and girls want to reduce their losses and one method is to push back down the chain.

- Loan purchasers make repurchase indemnity/demands on originators who frequently have no resources to honor them.
- Originators then push back to the broker who almost never has sufficient resources.

- Ø Perhaps most importantly, some of these demands would not have been made two years ago.
- Ø Some demands we see have minimal basis to support them.

An abundance of these demands flow from loan fraud, involving one or more of the original parties i.e., the borrower, the third parties involved with the borrower, or the broker. In the past, these situations sometimes were amenable to various types of work outs; sale, refinance or contributions from the parties to the fraud. In addition, other demands are made for more technical reasons. In any case, because of the disappearance of credit, particularly fringe credit and the depreciation in property values, work outs are few and far between. That leaves restructure of the loan as perhaps the only option, and only if the holder of the obligation agrees. Few are willing to do this.

In this unfriendly environment if you are a lender or a broker, and are hit by a demand for repurchase or indemnity, what can you do? The landscape may be a shade less bleak than you think.

- Ø <u>Review your contract</u>: Often the terms of the contract do not allow the party making the demand this option.
- Ø <u>Review your facts</u>: Again, the facts may not support the demand. (Particularly now, investors often stretch the contract terms or the facts to create a repurchase or indemnity situation where none exists or only arguably exists.)
- Ø <u>If your liability is clear</u>, offer a percentage of the amount demanded, or if your volume allows it, future market share, to settle the issue. Few of the companies initiating these claims actually want to proceed through the litigation and judgment collection process, particularly where, when they are done, there may not be a company there from which to collect.
- Ø <u>Fight the fraudulent "stated income" claim</u>. As a typical example, the borrower claims $8,000.00/month as a widget salesman. Two year later when the loan goes bad, Department of Labor statistics say that a widget salesman only averages $3,500.00/month, hence you (the lender or broker) who made an absolute warranty as to the accuracy of this borrower's representations are placed on the hook for fraud. There are many variants of this factual pattern and hence many variations of your argument. Suffice to say that there is, in our experience, a vast difference between what a "contract administrator", working for one of these large companies, believes is fraud in a stated income loan and what a court will sustain. Lay persons see stated income loans (this includes judges and juries) differently than the issuers of a repurchase demand.
- Ø Finally, we have a defense sometimes called "<u>mitigation of damages" or "laches"</u>. An example of the facts that would support this defense are as follows: A borrower commits fraud in 2004 to obtain a loan. The loan is in and out of default until the spring of 2007. At that time, the loan is in default and beyond hope. The borrower is out of work and/or long gone and the secured property is worth 75% of what it once was or alternatively, has recently been foreclosed and sold/acquired for 50% of its original value. <u>What would have happened if the investor had foreclosed on the property early on, taken action on the alleged fraud at the time it was discovered, or notified you of the circumstances in 2005</u>? Could the damages to you have been minimized, mitigated or even avoided? If you or the

servicer had become affirmatively involved two years before when the house was at full value, loan programs were much more generous and available and the borrower and loan broker were probably still motivated to work out of their fraudulent conduct, would you have a demand now sitting on your desk?

The facts of each situation we see are always different. The success of your argument will depend on these facts, the law in the state the loan is located in and, as always, the vagaries of litigation. What we have discussed here are not panaceas and often are subject to counter arguments, both legal and factual. The lesson however is that after that letter comes in the mail, or that phone call from your "rep", there may be a solution.

STATE ISSUES

CALIFORNIA:

New Disclosure Requirements for Nontraditional Loan Products

The California Department of Real Estate adopted a new regulation, Title 10, Section 2842 of the California Code of Regulations. This requires a licensee under the DRE to use a new disclosure of material information to be provided to prospective borrowers where loans involve nontraditional mortgage products. The term "Nontraditional Mortgage Product" is defined by the new regulation as an obligation that allows a borrower to defer repayment of principal or interest. Examples of these loans are interest only loans where a borrower pays no principal for a period of time or payment option loans where one of the possible payments could cause a loan to go into negative amortization.

The new form, which the Department of Real Estate will distribute, is RE Form 885. The form must be used in situations where the loan is a nontraditional mortgage and where a disclosure statement is required under Section 10240 and Section 10241 of the California Business and Professions Code.

The Department of Real Estate form can be found on the DRE website at www.dre.ca.gov.

INDIANA

Broker Exemptions Modified

As a reminder, please remember that on **July 1, 2007,** new loan brokers claiming an exemption in Indiana must file with the Indiana Securities Division, a Claim of Exemption form. The information relating to this exemption and other information concerning loan brokers can be found at www.in.gov/sos/securities/loanBroker/LBInfoWP.htm If you are a loan broker and claimed an exemption prior to this date of July 1, 2007, you have until **January 1, 2008** to file. The exemption currently requires a fee of $200 until July 1, 2008 at which time the fee will increase to $400.

The following loan brokers are exempt and are eligible to file a Claim of Exemption:

- Brokers selling or servicing a loan for Fannie Mae or Freddie Mac.
- Brokers issuing securities backed by GNMA.

- Brokers making a loan insured by the U.S. Department of Housing and Urban Development or the US Department of Agriculture.
- Brokers acting as supervised lenders or non-supervised automatic lenders of the U.S. Department of Veterans Affairs, and
- Brokers that act as loan correspondents for the US Department of Housing and Urban Development, <u>if that approved correspondent closes at least 25 such insured loan during each calendar year</u>. (This is the major revision.)

MASSACHUSETTS

New Rules for Mortgage Lenders and Mortgage Brokers

On **September 7, 2007** a new Massachusetts regulation, 209 CMR 42.00, became effective. The regulation sets up additional procedures and requirements for the licensing and supervision of mortgage lenders and brokers. The most significant amendments have to do with the bond and financial responsibility requirements.

Now, in order to maintain a license in Massachusetts, a licensee or applicant must have a bond in a sum based on the amount of the applicant's aggregate mortgage loans, but in no event less than $100,000 up to a maximum of $500,000. The bond must contain a clause that the insurance company will notify the Commissioner at least 30 days prior to canceling the surety bond for any reason. The Commissioner shall automatically suspend the license on the date the cancellation takes effect, if the bond has not been replaced or renewed.

Also, a mortgage broker must now have a net worth of not less than $25,000 and a bond of $75,000. The bond must contain similar notification provisions to the Commissioner prior to cancellation as the lender's bond. Applicants must also provide the Commissioner with evidence of financial responsibility and submit that information under oath.

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