

A Mortgage and Consumer Finance Law Update

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Federal Regulators and Prosecutors Ramp Up Resources in the Mortgage Fraud Arena

Continuing its aggressive post-Enron investigation of white-collar crime, the federal government has trained its sites on the mortgage financing industry. For example, the FBI recently announced: *“The FBI views mortgage fraud as a significant and growing crime problem. The mortgage lending and housing market have a considerable overall effect on the nation’s economy and combating mortgage fraud will remain a top priority for the FBI. ... The FBI is proactively working with the mortgage industry in an effort to curb mortgage fraud crimes.”*

On the legislative front, the U.S. House of Representatives' Committee on Financial Services is deliberating on a recently introduced bill that will significantly enhance regulatory oversight by the federal government. Specifically, H.R. 3915, the “The Mortgage Reform and Anti-Predatory Lending Act of 2007,” will reform mortgage practices in three areas. First, the bill will establish a federal duty of care, prohibit steering, and call for licensing and registration of mortgage originators, including brokers and bank loan officers. Second, the new legislation will set a minimum standard for all mortgages which states that borrowers must have a reasonable ability to repay. Third, the legislation attaches limited liability to secondary market securitizers who package and sell interest in home mortgage loans outside of these standards. However, individual investors in these securities would not be liable. Finally, the bill expands and enhances consumer protections for “high-cost loans” under the Home Ownership and Equity Protection Act and includes important protections for renters of foreclosed homes.

Not to be outdone, the Securities and Exchange Commission has also stepped up enforcement for publicly traded companies involved in the mortgage industry. For example, in response to Merrill Lynch Inc.'s disclosure that it will write down \$8 billion due to subprime mortgage exposure, the SEC has initiated an investigation to take a closer look at the way the investment bank values its mortgage-backed securities. As recently reported in the *Wall Street Journal*, the SEC is investigating reports that Merrill made several deals with hedge funds designed to hide its mounting debt due to losses from mortgage-backed securities.

Finally, on the local front, federal enforcement is heating up here in the Pacific Northwest. Both the United States Attorneys Offices in Seattle and Portland have geared up Mortgage Fraud Working Groups and have partnered up with various state and federal agencies, including the Office of Thrift Supervision, the Federal Deposit Insurance Corporation and the Federal Trade Commission to investigate and prosecute mortgage fraud. Indeed, the fallout from this increased

scrutiny has already surfaced locally: Bremerton-based Westsound Bank recently announced that it is being investigated by federal and state regulators for possibly violating banking laws, including fraud and misconduct violations.

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