MORRISON | FOERSTER

Legal Updates & News

Legal Updates

Mortgage Report

March 2007

Related Practices:

- Financial Services Law
- Financial Services Litigation
- Litigation

The Pendulum Swings Back

In our Summer 2006 issue, we reported on a closely watched appeal in the First Circuit involving a class certification order in a TILA rescission case. On January 29, the First Circuit reversed the much-criticized class certification order in *McKenna v. First Horizon Home Loan Corp.*, No. 06-8018, 2007 U.S. App. LEXIS 1901 (1st Cir. Jan. 29, 2007). The court held that rescission claims under TILA cannot be aggregated for class action purposes because "Congress did not intend rescission suits to receive class-action treatment." Adopting the views promoted by First Horizon and the industry *amici*, the court concluded that TILA's $500,000 class action damages cap implicitly bars class action treatment of rescission claims, which would impose on lenders "overwhelming liability for relatively minor violations."

A few days before *McKenna* was decided in the First Circuit, the Court of Appeal in California reached the same conclusion in *LaLiberte v. Pacific Mercantile Bank*, 147 Cal. App. 4th 1 (2007). The court expressly rejected the *McKenna* trial court's class certification order and concluded that rescission claims are not subject to class action treatment because of the "catastrophic" potential liability that could be imposed on businesses subject to such actions.

McKenna and *LaLiberte* somewhat temper the effects of the pro-plaintiff decisions of *Barrett v. JP Morgan Chase, N.A.*, 445 F.3d 874 (5th Cir. 2006), and *Pacific Shore Funding v. Lozo*, 138 Cal. App. 4th 1342 (2006), handed down in April 2006, which both held that TILA does not bar rescission of loans that already have been repaid or refinanced. Although *Barrett* and *Lozo* expand the universe of potentially rescindable claims, *McKenna* and *LaLiberte* hold that that universe cannot be aggregated into a class claim.

Practice Tip: After *Turner v. Beneficial Corp.*, 242 F.3d 1023 (11th Cir. 2001) and cases of that ilk ended "actual damages" class actions under TILA due to the "reliance" element, the lurking question has been whether there can be "rescission" class actions under TILA. *McKenna* and *LaLiberte* say no, which means that the only class action exposure facing a creditor for TILA violations is for statutory damages, but those are capped at $500,000.

For more information, contact Eric Olson at eolson@mofo.com.

Captive Re Wars

We have been tracking in these pages the ongoing investigations by state Attorneys General and insurance regulators into the relationships between mortgage lenders and their captive reinsurers. Recently, several new class actions have been filed against large mortgage lenders who have captive reinsurance programs.

These suits are all venued in California federal court and are brought by the same class counsel. All of them seek certification of a national class action and allege violations of the Real Estate Settlement Procedures Act ("RESPA"), in particular, for allegedly collecting illegal referrals from their captive reinsurers. The claim is that by arranging for borrowers to obtain private mortgage insurance

(PMI) from captive reinsurers, these lenders are accepting kickbacks and unearned fees in violation of RESPA in that an excessive portion of the premiums paid by borrowers is ostensibly paid for reinsurance premiums that is unrelated to the reinsurance risk. These suits against Countrywide, Washington Mutual, and GMAC Mortgage are surprising, seeing as how the industry for many years has conformed its captive PMI reinsurance arrangements to the standards of RESPA compliance articulated by HUD and ratified by several federal judges when adjudicating similar claims brought against the PMI providers.

For more information, contact Michael Agoglia at magoglia@mofo.com.

FDIC Chimes In on Predatory Lending

On January 22, 2006, the FDIC issued its supervisory policy letter on predatory lending. The letter identified the characteristics of predatory lending as making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation, inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced, and engaging in fraud and deception to conceal the true nature of the loan obligation or ancillary product from an unsuspecting or unsophisticated borrower. The letter reaffirmed that the above activities are inconsistent with safe and sound lending, and reiterated that the FDIC will use "vigorous safety and soundness and compliance examinations and enforcement, industry outreach and adult financial education programs" to address predatory lending issues. A copy of the FDIC's supervisory policy letter can be found at http://www.fdic.gov/news/news/financial/2007/fil07006a.html.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Countrywide Settles HMDA-Based Inquiry

New York's inquiry into Countrywide Financial Corp.'s fair lending practices has been settled with Countrywide's agreement to set up a $3 million consumer education fund and other reforms. The inquiry was initiated by then-A.G., now-Governor Elliot Spitzer after publication of the 2004 HMDA (Home Mortgage Disclosure Act) data disclosures showed that African-American and Latino customers were more likely than others to receive high-priced loans. Spitzer's investigation of Countrywide is part of a broader investigation into pricing differentials disclosed by the 2004 HMDA data. Several national banks, including Citigroup, HSBC, and Wells Fargo, have successfully argued in federal court in New York, with full backing of the OCC, that they are shielded from scrutiny by state regulators.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Countrywide Cleared

More on the Countrywide front. In our last few issues, we have reported on some of the increased RESPA scrutiny various lending practices involving affiliates or subsidiaries have received from courts and regulators. In late December, the U.S. District Court, S.D. Georgia, cleared Countrywide of allegations that it had been "kicking back" a portion of the plaintiffs' loan settlement fees to a subsidary that provided credit report services in those loan transactions. The court granted Countrywide summary judgment, holding that the fees charged for the credit report services were bona fide compensation under RESPA's safe harbor provisions. *See Price v. Landsafe Credit, Inc.*, No. CV205-156, 2006 U.S. Dist. LEXIS 92909 (S.D. Ga. Dec. 22, 2006).

For more information, contact Michael Agoglia at magoglia@mofo.com.

"CHARM" Those Borrowers

The Fed recently issued a revised CHARM booklet—that is, the Consumer Handbook on Adjustable-Rate Mortgages—for distribution to new borrowers. Reg Z requires that the CHARM booklet, or a suitable substitute, be provided to consumers with every adjustable rate mortgage. Lenders must begin using the revised booklet by October 1, 2007. The English-language version of the booklet is available on the Internet at http://www.federalreserve.gov/pubs/arms/arms_english.htm. The Spanish-language version is forthcoming.