

Memorandum



One
Financial
Center
Boston
Massachusetts
02111
tel 617.856.8200
fax 617.856.8201

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TO Mortgage Lenders (including Banks) and Brokers

FROM Nancy R. Wilsker

RE Massachusetts Attorney General's Mortgage Lender/Broker Regulations

This is a notice regarding the Massachusetts Attorney General's most recent revisions to the **Regulations Under Chapter 93A – Mortgage Lenders and Brokers** (the "Regulations"). Our earlier Client Alerts on this subject (dated November 5 and 14, 2007) are available at www.brownrudnick.com/nr/alerts.asp. On December 18, 2007 the Attorney General issued a revised version of the Regulations along with industry guidance regarding their implementation (the "Guidance"). Copies of the Regulations and the Guidance are attached to this memorandum. **There are significant changes of which you should be aware.** Please note, however, the effective date has not changed: **the effective date for all parts of the Regulations is January 2, 2008.**

There are two important changes in the newly-revised Regulations:

1. The two borrower disclosure forms previously included in Section 8.05 – one to be provided by the lender and the other by the broker – have been deleted.
2. The "stated income" section has been revised to provide that a borrower's signed statement of income is not required for a "no income" loan product (in which the lender does not consider employment status or income at all), although the lender may still be required to disclose that the loan product entails higher costs or less favorable terms, if that is the case.

Summary of Regulatory Provisions

As has been noted previously, the MA Attorney General first adopted regulations governing mortgage lenders and brokers in 1992. The AG's current actions modify the existing regulations: they do not create entirely new regulations. For example, the five "unfair or deceptive" advertising practices that are prohibited by Section 8.04 are not new. Similarly, the obligation in Section 8.05(3) to "communicate the material facts of the transactions in a language that is understood by the borrower," including using adult interpreters or providing translated copies of the disclosure forms, is not new.

Here is a summary of the new provisions and prohibitions:

1. The new Regulations apply to all residential mortgage loans in Massachusetts except (a) reverse mortgages; (b) open-end equity lines of credit; and (c) reduced rate mortgages originated under affordable housing programs and administered by state, quasi-public, or local government entities. Pre-2008 regulations also contained an exemption for loans to finance the acquisition or initial construction of the property; that exemption has been deleted.



2. The definition of “mortgage broker” excludes – and always has excluded – persons who are exempt from licensing under M.G.L. c. 255E §2 (essentially, banks, persons who broker fewer than 5 loans per year, and employees of licensed brokers). The new Regulations eliminate (for purposes of the AG’s Regulations only) the exemption for employees of licensed brokers. **Please note** that nothing in the AG Regulations eliminates the licensing exemption for employees of licensed brokers (although a new state statute, effective July 1, 2008, will require many individual brokers to become licensed as “mortgage loan originators”).
3. Section 8.05 of the Regulations has always included two disclosure forms – one to be used by lenders and one by brokers – that were required to be provided to prospective borrowers during the application process. The AG modified those forms in the version of the Regulations that was issued in October 2007. **These disclosure forms were eliminated in the final version of the Regulations.** The current disclosure requirement in Section 8.05 is limited to a requirement that the lender and broker comply with all disclosure requirements of “any applicable state or federal law, regulation or directive.”
4. Section 8.06 of the Regulations contains a list of 18 “unfair or deceptive acts or practices” that mortgage lenders and brokers are prohibited from committing. Fourteen of those practices are carry-overs from the original Regulations. The following 4 are new:
 - a. Paragraph 15 prohibits a broker from arranging and a lender from making a mortgage loan “unless the mortgage broker or lender, based on information known at the time the loan is made, reasonably believes at the time the loan is expected to be made that the borrower will be able to repay the loan based upon a consideration of the borrower’s income, assets, obligations, employment status, credit history, and financial resources, not limited to the borrower’s equity in the dwelling which secures repayment of the loan.” The broker/lender must “take into account” the fully-indexed rate, scheduled payment changes, and property tax and insurance payments (whether or not required to be escrowed). **The Guidance makes clear that this provision “does not dictate precisely how lenders and brokers must underwrite ARM loans to account for those upward adjustments.”** However, if there is a short discount period (a year or two), the Guidance suggests that the loan should be underwritten at the fully-indexed rate; if there is a long discount period (7-10 years), the fully-indexed rate must still be “taken into account,” but underwriting at that rate is probably not required.
 - b. Paragraph 16 prohibits making a “stated income” loan (one without documentation to verify the borrower’s income) unless the lender or broker provides, and the borrower signs in advance of closing, a written document (a) identifying the borrower’s income and the source of the income; and (b) providing detailed information, if applicable, that the loan has a higher interest rate or less favorable terms than a similar loan with income verification. Part (a) of the requirement (but not Part b) is eliminated if the lender does not consider the applicant’s income or employment status in any manner and that fact is set forth in written loan underwriting or origination policies governing the loan product. The Regulations also prohibit the broker or lender from making or processing a stated income loan where the income stated by the borrower contradicts information previously obtained by the broker or lender (absent a documented explanation) or where the stated income is not reasonable based on the borrower’s employment status, experience, or other circumstances known to the lender.



- c. Paragraph 17 prohibits a broker from arranging a mortgage loan “that is not in the borrower’s interest.” Any transaction in which the broker’s interests conflict with the borrower’s interests (such as where the broker receives a higher fee if the borrower pays a higher interest rate) is considered to be “not in the borrower’s interest.” The Guidance states that this provision is not intended to prohibit the use of yield spread premiums and that the Regulations recognize that brokers can and should be paid for their services. However, the Regulations are intended to make the broker’s compensation more transparent to the borrower and to ensure that the broker’s compensation is not increased at the expense of the borrower. For example, the Guidance provides examples of transactions in which the borrower can elect a lower interest rate with points paid at closing to cover the broker’s fee or a higher interest rate from which the lender pays the broker a yield spread premium, provided that, regardless of which option the borrower selects, the broker receives the same compensation. **Please note** that a conflict of interest cannot be cured by disclosing it to the borrower: the Regulations simply prohibit the broker from proceeding with the transaction.

- d. Paragraph 18 prohibits a lender from (a) using a pricing model for its mortgage loans that treats borrowers with similar credit criteria and bona fide qualification criteria differently; or (b) making a mortgage loan when any or all of the cost features of the mortgage loan are based on criteria other than the borrower’s credit and other bona fide qualification criteria. The Regulations do not specify what the “bona fide credit qualifications” should be, but does require that they be articulated in the borrower’s written loan underwriting or origination policies. Thus, lenders can offer preferred terms to borrowers who are existing customers or who agree to pay by automatic debit, provided those criteria are reflected in the lender’s written origination policies and are consistently applied.

Other Guidance of note:

The Guidance also contains the following helpful information:

1. Banks and other depository institutions – when acting as mortgage lenders – are subject to the Regulations. If a bank were acting as a broker, it would be exempt because any entity exempt from broker licensing under M.G.L. c. 255E §2 is also exempt from the AG Regulations. However, entities exempt from lender licensing under M.G.L. c. 255E §2 are not exempt from the AG’s Regulations, so banks and other depository institutions acting as lenders must comply with the Regulations.
2. The Regulations apply only to transactions for which the loan application is completed on or after January 2, 2008. Transactions for which the application was completed prior to January 2, 2008 are not subject to the Regulations, even if the loan is closed after that date.
3. Paragraph 18 does not prohibit lenders from offering a lower interest rate in order to meet or beat a competitor’s offer, *provided* (a) competitive factors were included in the lender’s written loan underwriting or origination policies and (b) such pricing flexibility is not used as a subterfuge for prohibited price gouging.

Please contact me if you have any further questions. I can be reached at (617) 856-8343 or [NWisker@BrownRudnick.com](mailto:NWiisker@BrownRudnick.com).