CLIENT ALERT

New Massachusetts Regulations Affecting the Residential Mortgage Lending Industry

Massachusetts Attorney General Martha Coakley recently filed regulations (the "Regulations") affecting the residential mortgage lending industry. The Regulations are being issued under the Attorney General's authority to regulate "unfair or deceptive acts or practices" pursuant to the Massachusetts Consumer Protection Act (General Laws ch. 93A) and will be codified at 940 CMR (Code of Massachusetts Regulations) 8. By and large, the Regulations refine and reenact regulations that have been in effect since 1993. The Regulations do, however, add some significant new requirements.

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Effective date

The Regulations are effective November 15, 2007, except that use of the new disclosure forms specified in the Regulations is not required until January 2, 2008.

Who is covered?

The Regulations apply to "mortgage brokers" and "mortgage lenders."

Basically, a "mortgage broker" is defined as: "…any person, who for compensation or gain, or in the expectation of compensation or gain, directly or indirectly negotiates, places, assists in placement, finds, or offers to negotiate, place, assist in placement, or find mortgage loans on residential property for others." However, the Regulations exclude persons who are exempt from licensing under Massachusetts General Laws ch. 255E §2 (other than employees of licensed brokers) and state- or federally-regulated financial institutions that broker loans for their own affiliates or subsidiaries.

A "mortgage lender" is defined as "…any person engaged in the business of making mortgage loans or issuing commitments for mortgage loans."

What loans are covered?

The term "mortgage loan" is defined to be a loan to a natural person primarily for personal, family or household purposes that is secured by a mortgage on a one- to four-family, owner-occupied dwelling. Open-end home equity lines of credit and

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reverse mortgages are excluded. *Under the previous version of the Regulations, loans to finance the acquisition or initial construction of the property were also excluded. That exclusion was deleted in the new Regulations, making loans to finance the acquisition or initial construction of the property subject to the Regulations for the first time.*

What is new?

The Regulations adopt new disclosure forms (replacing existing forms) that must be provided to a mortgage applicant early in the application process. The Regulations also define new "unfair or deceptive acts or practices" that:

- Prohibit brokers and lenders from making a loan unless they have a reasonable belief that the borrower will be able to repay the loan;
- Restrict the use of "no documentation" or "stated income" loans;
- Prohibit brokers from making, processing or arranging loans that are not in the borrower's interest or where the borrower's interest conflicts with the broker's interest; and
- Prohibit lenders from discriminating among similarly situated borrowers or from steering borrowers to loans that are more costly than others for which they qualify.

Disclosure Forms

The Regulations contain two forms of Important Notice of Loan Terms: one designed to be used by brokers and one designed to be used by lenders (the "Disclosure Forms"). Unlike the prior regulations, which permitted customization of the forms, the Regulations require that the Disclosure Forms to be used by lenders and brokers going forward strictly conform to the forms in the Regulations. They must be printed in at least 11-point Times New Roman font on a single page, separate from other disclosures. (Presumably, the forms may be printed on the front and back of a single page, as they will not fit on a single side of an 8½ × 11 sheet.)

As before, the Disclosure Forms must be provided within three (3) business days after the earliest of:

- The receipt ("acceptance," for the broker) of an oral or written loan application;
- Any communication that leads the broker or lender to incur expenses on behalf of the borrower (but now the broker may incur the expense of obtaining a credit report before providing the disclosure);
- Any oral or written agreement between the borrower and broker or lender; and
- In the case of the lender, issuance of any commitment.

An additional change that may be problematic for some lenders is that any change to the information contained in the Disclosure Forms must be disclosed to the borrower in writing at least three (3) business days before the closing.

Under the prior regulations, lenders were not required to provide the AG's disclosures on any loan for which the lender provided the disclosures required under General Laws ch. 184 §17D (the *Uniform Mortgage Loan Cost Worksheet* and *Glossary*). Because G.L. c. 184 §17D was repealed in 2006, this exemption was removed from the Regulations. Lenders must now provide the AG Disclosure Form on all covered loans.

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In addition, the Regulations made some less significant changes to other disclosure requirements. Lenders are now required to provide a legible copy of the settlement statement (in addition to the note and mortgage) at the time of closing. Also, it is now an unfair or deceptive act or practice to fail to provide any documents or disclosures required by any other state or federal law.

Ability to Repay

The Regulations prohibit a broker or lender from arranging or making a loan unless, based on information known at the time the loan is made, the lender and broker reasonably believe that the borrower will be able to repay the loan at a fully-amortizing repayment schedule based on the borrower's income, assets, obligations, employment status, credit history, and financial resources (including, but not limited to, the mortgaged property).

On a variable rate loan, ability to repay must be determined based on the fully indexed rate, ignoring any initial rate discount or rate adjustment limitations that may affect how quickly the fully indexed rate may be reached.

The Regulations give this example:

> *Assume that a loan with an initial fixed rate of 7% will reset to the six-month London Interbank Offered Rate (LIBOR) plus a margin of 6%. If the six-month LIBOR rate equals 5.5% at the date of origination, the determination of ability to pay under this subsection shall take into account the borrower's ability to repay at 11.5% (5.5% plus 6%).*

Whether or not the lender escrows taxes and insurance, the borrower's ability to pay must also take into consideration real estate taxes on the property and, if insurance is required under the terms of the loan, reasonably anticipated insurance costs.

"No Documentation," "Limited Documentation" and "Stated Income" Loans

Brokers and lenders may not process or make loans without documentation to verify the borrower's income (a no- or limited-documentation loan) unless the broker or lender provides the borrower with a written disclosure, which must be signed prior to closing, that:

- Identifies the borrower's income and the source of the income; and
- States (if true) that the borrower will pay a higher interest rate, increased charges, or less favorable terms as a result of the no- or limited-documentation loan, and identifying the exact increases that apply.

Brokers and lenders may not process or make a no- or limited-documentation loan if the stated income provided by the borrower contradicts other information obtained by the broker or lender regarding the borrower, absent a documented explanation of the discrepancy.

A lender may not process or make a no- or limited-documentation loan if the stated income provided by the borrower is not reasonable for the borrower's employment status, experience level, or other circumstances known to the lender.

Borrower's Interest

A broker may not process a mortgage loan that is not in the borrower's interest. The Regulations do not explain this statement further, nor do they explain how to determine if a loan is in the borrower's interest. Brokers might draw on the "borrower's interest" standard established in Massachusetts General Laws ch. 183 §28C (relating to home loan refinancings), but the Regulations

should not be construed narrowly and a loan cannot be conclusively deemed to be in the "borrower's interest" simply because it satisfies the requirements of §28C. At the very least, brokers should also consider whether there are more favorable terms available to the borrower and whether the borrower has the ability to repay the loan (determined as discussed above).

A broker may not process an application or make or arrange a loan where the financial interests of the broker conflict with the interests of the borrower. The broker must disclose the conflict to the borrower. The Regulations state, as an example, that a conflict would exist if the broker's compensation would increase, directly or indirectly, if the loan had a higher interest rate, increased charges or less favorable terms than those for which the borrower would otherwise qualify.

Discrimination and Steering

Mortgage lenders may not discriminate among borrowers with similar credit criteria and "bona fide qualification criteria." The phrase "bona fide qualification criteria" is defined to mean "those criteria that a lender, pursuant to written loan underwriting or origination policies, takes into account in determining whether to extend a mortgage loan, including by way of example, income, assets, credit history, credit score, income-to-debt ratios or loan-to-value ratios."

Lenders are also prohibited from making mortgage loans where the "cost features" of the loan are based on factors other than the borrower's credit and other bona fide qualification criteria. "Cost features" include, but are not limited to, interest rate, index, margin, and other adjustment features if the interest rate is variable, points, and prepayment penalties.

If you have any questions regarding the Massachusetts Attorney General's new mortgage lending regulations, please contact:

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