

# Mortgage Broker Liability

Presented by:

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# Discussion Topics

- I. General Intro
- II. Players in the Mortgage Process
- III. Mortgage Broker Duties and Standard of Care
  - a. Duties Created By Contract
  - b. Duties Affected by Regulation
  - c. Industry Standard of Care
  - d. Policing the Mortgage Broker

# Topics for Discussion (continued)

- IV. Duties Of Others in the Mortgage Process
  - A. Mortgage Bankers
  - B. Appraisers
  - C. Borrowers
  
- V. Types of Claims Against Brokers
  
- VI. Potential Defense Approaches
  
- VII. Trends
  
- VIII. Recent Decisions

# I. General Intro

- Ten Years Ago, 5% of all mortgage originations were sub-prime
- 2005 – Figure at approximately 20%
- Over \$600 Billion in new sub-prime loans originated in 2006
- Subprime loan defaults and delinquencies have grown steadily
- 61 Lenders have gone out of business since mid-2006 alone

# I. General Intro (continued)

- General State of Mortgage Broker Industry
  - A. More lenders facing defaults/losses/buy-backs
  - B. Not just sub-prime, all other loss situations more poignant – first mortgage, regular re-finance loans
  - C. Lenders will be more aggressive in seeking recourse

## II. Players in the Mortgage Process

- Fannie Mae / Freddie Mac
- Mortgage Bankers / Lenders
- Mortgage Broker
- Appraisers
- Real Estate Brokers/Agents

## II. Players (continued)

- **Fannie Mae - Federal National Mortgage Corporation**
  - a government sponsored enterprise – a privately owned corporation authorized to make loans and loan guarantees
- **Freddie Mac - Federal Home Loan Mortgage Corporation**
  - a government sponsored enterprise – a stock-holder owned corporation authorized to make loans and loan guarantees

**Both part of secondary mortgage market** – helps to replenish the supply of money that can be loaned for mortgages and ensures that money continues to be available for new mortgages – they charge a fee and essentially guarantee that principal and interest will be paid back

## II. Players (continued)

### Mortgage Bankers

- Wholesalers

- Loan production – originate and fund new loans, acquire already funded loans through purchases from other lenders
- loan servicing – collect payments from the borrower, remit to investor (minus servicing fee)

- Retailers - fewer companies now close, keep and service the loan – more are sold in the wholesale/secondary market

## II. Players (continued)

- **Mortgage Brokers** - intermediate who sources mortgage loans on behalf of individuals or businesses
  - **Majority of mortgage brokers are regulated to ensure a level of protection for the consume – depends on the jurisdiction**
  - **Tasks Include**
    - marketing/attracting clients
    - assessment of borrower – income/credit
    - assessing market for suitable loan product
    - securing pre-approval
    - gather all needed documentation for loan criteria
    - completing loan application
    - explaining the legal disclosures
    - submitting all materials to the lender

## II. Players (continued)

- **Appraisers** - regulated state by state
  - Pennsylvania - Governed by Rules and Regulations of the State Board of Certified Real Estate Appraisers - 49 Pa. Code Sections 36.1 – 36.53
    - Governs application and approval process
    - Governs continuing education
    - Sets standards of practice – basically comply with USPAP -
      - *Uniform Standards of Professional Appraisal Practice* – from the Appraisal Foundation

## II. Players (continued)

- Real Estate Brokers/Agents

# III. Mortgage Broker Duties and Standard of Care

- Duties Created By Contract

- \* watch for onerous e-contracts – generally enforceable

- sample binding language:**

- .....**Electronic Signature** (In the event that the parties execute this Agreement electronically, the following shall be in effect): By submitting this online registration, I, as a duly authorized officer of Broker, acknowledge that I have reviewed the foregoing Agreement and agree, for and on behalf of Broker, to be bound by the terms and conditions set forth in this Agreement if [LENDER] accepts the request of Broker to become an approved "Broker" hereunder. I understand that [LENDER] will notify me electronically if my application to become an approved Broker is accepted. and that this Agreement shall become binding on Broker effective on and as of the date of such notice by [LENDER].

# III. Broker Duties, etc. (continued)

## – Additional sample language

- .....**Electronic Signature** (In the event that the parties execute this Agreement electronically, the following shall be in effect): By submitting this online registration, I, as a duly authorized officer of Broker, acknowledge that I have reviewed the foregoing Agreement and agree, for and on behalf of Broker, to be bound by the terms and conditions set forth in this Agreement if [LENDER] accepts the request of Broker to become an approved "Broker" hereunder. I understand that [LENDER] will notify me electronically if my application to become an approved Broker is accepted, and that this Agreement shall become binding on Broker effective on and as of the date of such notice by [LENDER].
- .....I understand that this agreement imposes certain contractual duties and obligations upon Broker.

## III. Broker Duties, etc. (continued)

### – Additional sample language

- .....I understand that [LENDER] will conduct a background check that may require accessing certain personal and/or business credit and other information regarding Broker. By submitting this registration. I, on behalf of Broker, authorize [LENDER] to obtain such information.
- .....I further represent and warrant that I am a duly authorized officer of Broker and I have been properly authorized by Broker to accept, consent to, and electronically execute and deliver this Agreement for and on behalf of Broker and, by doing so, I hereby make this agreement a legal, valid, binding and enforceable obligation of Broker.

# III. Broker Duties, etc. (continued)

- Onerous burden placed on broker under contract
- **Sample language re: duties / obligations:**

.....The Broker represents and warrants that each loan application and loan package submitted to Lender for review, including all borrower information and other data and materials contained therein, **is true and correct, contains no untrue statements. does not omit any facts or information necessary to make the statements or information submitted not misleading. is accurate. and reveals any relevant facts and information.** Relevant facts and information include, but are not limited to, income, reasonableness of income, assets, funds on deposit, occupancy intentions/status, and employment of the borrower; **property valuation/appraisal**, good and marketable title as represented by the preliminary title report, and other supporting loan package documentation. Broker understands that by making the warranty contained in this subparagraph that it is warranting that it has diligently verified the accuracy and completeness of all information submitted in support of the Loan being sought from Lender, and that **all such submitted information is true and correct.**

### III. Broker Duties, etc. (continued)

- **Additional sample language**

.....Broker represents and warrants that there is **no circumstance, condition, or event that will or may cause a Borrower to default**, or that will cause secondary market investors, agencies or insuring entities to consider a loan to be an unacceptable investment.

## III. Broker Duties, etc. (continued)

### – Additional language

- .....**Representations and warranties True at Closing.** The representations and warranties made by Broker under this Agreement shall be true, accurate, and complete in all respects at all relevant times, including but not limited to the date(s) any Loan is funded by Lender and the Loan transaction closes. Broker shall immediately give notice to lender in writing before closing if broker discovers, or has reason to suspect, that any of its representations or warranties may no longer be true, accurate, or complete.

### III. Broker Duties, etc. (continued)

– **Language re: Insurance Obligation**

- **... Insurance.** Broker shall maintain policies of comprehensive general liability insurance, errors and omissions insurance, fidelity bond or other insurance typically maintained by prudent mortgage brokers in the industry. **Broker shall indemnify and hold Lender harmless from and against any and all claims, demands or causes of action related to the performance of Broker's activities as contemplated by this Agreement.**

# III. Broker Duties, etc. (continued)

## – Language regarding indemnification

- ....**Indemnification.** Broker shall indemnify and hold Lender harmless from and against, and at Lender's option, defend, all claims, losses, expenses, and damages incurred or suffered, or to be suffered, by Lender including without limitation, claims, damages, losses, and expenses incurred in connection with the sale or repurchase by Lender of a Loan or as a result or arising out of: (a) any breach of Broker's representations, warranties, or covenants or (b) Broker's non performance of its obligations under this Agreement. In addition, the broker will repay Lender the yield spread premium and any premium pricing above par (100% of the original loan amount). For example, if the original loan funded at 103, including the yield spread premium, the Broker would be required to pay Lender 3% or the entire premium above par paid to broker by Lender at close of said transaction. The foregoing indemnification obligations include, but are not limited to attorneys' fees and costs and subsequent re-selling costs.

# III. Broker Duties, etc. (continued)

## – Specific contractual obligations

### ■ *Sample language from Countrywide Broker Agreement*

- **Duties of Broker**. With respect to each loan submitted by Broker to Countrywide for underwriting and funding, Broker shall:

(a) have and maintain the exclusive ongoing contact with Loan applicant....from the time of application until closing;

(b) undertake all direct and face-to-face personal interviews with applicant;

(c) educate and assist applicant in understanding the home buying and financing process;

### **III. Broker Duties, etc. (continued)**

(d) discuss the different types of loan products available, explain the qualification and eligibility requirements for each product, and demonstrate how closing costs and monthly payments may vary under each product;

(e) gather all information and documentation needed to complete the loan application including applicable information required by applicable state and federal law and any regulations related thereto;

(f) assist applicant in filing out all Loan applications;

(g) collect and analyze financial information and related documents and assist applicant in determining the mortgage that applicant can afford;

### **III. Broker Duties, etc. (continued)**

(h) assist applicant in identifying potential credit problems and obtaining letters of explanation;

(i) provide and discuss with applicant the documents required by the FHA and Department of Veteran's Affairs, if applicable;

(j) keep applicant apprised of the status of applicant's application and communicate any changes in the loan terms within a reasonable timeframe;

(k) maintain regular contact with applicant, real estate agents and Countrywide, as needed;

(l) deliver to applicant a good faith estimate meeting the requirements of RESPA within 3 days of receipt the loan application;

### III. Broker Duties, etc. (continued)

- (m) Provide to applicant such additional disclosures as are required to be provided by Broker, Countrywide or applicable federal or state law...;
- (n) collect the fees for the property appraisal or the VA Certificate of Reasonable Value, if applicable, and credit report and if required by applicable law, deposit such fees in a trust account;
- (o) request the property appraisal and gather preliminary materials from applicant including, if applicable, the VA Certificate of Eligibility;
- (p) participate in the loan closing, if applicable;
- (q) perform any other service as Countrywide may from time to time reasonably request.

# III. Broker Duties, etc. (continued)

- Mortgage Brokerage Contract – Borrower’s Contract with Broker - **Sample Language** -
  - *Services to be Provided by Mortgage Brokerage Business*
    - In consideration for Business earning its fee, the services provided by Business are:
      - Assembling information, compiling files and completing credit application for borrower(s);
      - Processing the application file including verifying of information received and ordering vendor reports;
      - Preparing and submitting the completed file for conditional loan commitment between borrower(s) and lender; and
      - Any incidental services necessary to obtain commitment including courier, express mail, photographs, and telephone toll charges.
  
- Third Party Beneficiary potential

# III. Broker Duties (continued)

- Duties Affected by Regulation
- Pa. Department of Banking Regulations – likely to be enacted within the next 6-8 months
  - ***Proposed Rulemaking, Proposed Regulations and Statement of Policy Regarding the Conduct of Licensees in the Mortgage Loan Business***
    - wants to get more information out to borrowers, for better decisions, avoid loss of homes
    - recognizes brokers can take advantage by placing borrowers in loan products that cannot repay from the inception

## III. Broker Duties (continued)

- References *Secondary Mortgage Loan Act*, 7 P.S. Section 6601, et. seq.
  - Primarily focuses on second mortgages and specific limitations imposed on circumstances and specific provision of the loan agreements/clauses

### III. Broker Duties, etc. (continued)

- References *Mortgage Bankers and Brokers and Consumer Equity Protection Act, 63 P.S. Section 456.101, et. seq.*

- Focusing on Predatory Lending – Informed Decisions by the Borrower

# III. Broker Duties, etc. (continued)

- Key Provisions of Proposed Banking Regulations (Chapter 46)
  - Specific communications with the borrower regarding the loan products
    - cannot just rely on the documents for terms and conditions
  - Several disclosures must be made in writing
    - Escrow plans for taxes and insurance
    - If licensee is lender with ability to lock in rates
    - If there is a prepayment penalty on the loan
    - Variable interest rates, demand payment provision or balloon payment features

### **III. Duties of Broker, etc. (continued)**

- Licensees may not offer a loan to an applicant without reasonable information and belief that the applicant will have the ability to repay the loan

## III. Broker Duties, etc. (continued)

- Factors in determining if applicant can repay loan
  - Purpose of loan
  - Income
  - Property value
  - Applicable taxes and insurance
  - Escrow status / affect on monthly payments
  - Applicant's fixed expenses
  - Impact of an prepayment penalty
  - Ability to make payments under variable rates, etc.
  - Cumulative effects of refinancing

## III. Broker Duties, etc. (continued)

- Licensee may not
  - Advise/imply that income is not relevant
  - Recommend any default on existing obligation
  - Cannot repeatedly suggest they obtain loan if financial resources insufficient
  - Offer one type of loan for which applicant is qualified when he/she is also qualified for better loan product
  - Any suggestion that documents/disclosures are not important
  - Have applicant sign blank forms, allow witnesses to not be present, etc.
    - any improper execution document
  - Submit or encourage any false information
  - Obtain insurance without allowing applicant to obtain own
  - Charge a fee for any notices or disclosures
  - Share compensation with anyone not properly licensed
  - Render legal advice

## III. Broker Duties, etc. (continued)

- Licensee may not improperly influence or attempt to improperly influence:
  - outcome of appraisal / compromise the independent judgment of an appraiser
  - Any other entity in process such as notaries, title companies, real estate agents or builders

# III. Broker Duties, etc. (continued)

- Chapter 48 of Proposed Regulations

## **Focus on Dishonest / Fraudulent Practices**

- "Licensee under the act should not engage in any dishonest, fraudulent or illegal practices or conduct or unfair or unethical practices or conduct in connection with the first mortgage loan business or be negligent or incompetent in performing any act for which a license is required under the act."

### III. Broker Duties, etc. (continued)

- **Dishonest practice or conduct** – characterized by lack of truth, honesty or trustworthiness, or is unfair or deceptive or implies a willful perversion of the truth in order to deceive, cheat or defraud
- **Fraudulent practice or conduct** – characterized by deceit or trickery, intentional perversion of the truth to induce another to part with something of value or surrender a legal right, or an act of deceiving or misrepresenting + any act defined as fraud under applicable law
- **Illegal practice or conduct** – characterized as not according to or authorized by law

### III. Broker Duties, etc. (continued)

- **Unfair Practice or Conduct** - characterized as being marked by injustice, partiality or deception, or being inequitable in business dealings – not conforming with the moral norms or standards followed in profession
- **Negligence** – as defined by the courts of the Commonwealth
- **Incompetence** – characterized as inadequate or unsuitable for a particular purpose, lacking the qualities needed for effective action

## III. Broker Duties (continued)

- Industry Standard of Care – expert opinion on what a broker should do
  
- Interview Process
  - 1003 (Application) – good broker will use this at the point of contact, asking all questions on the applications
    - Liabilities section – can use the credit report to fill this out – all other information should come directly from the applicant
  - Less thorough brokers use “mini-application” or telemarketing form

# III. Broker Duties, etc. (continued)

- Industry Standard of Care
  
- Good Faith Estimate
  - Should be a fairly accurate measure of closing costs
  - Should match up fairly closely with HUD-1 given at closing
    - Some things can change – taxes, impounds, true 3<sup>rd</sup> party fees
    - Broker fees, origination fees, processing fees are all profit – these should not change
    - Fee that broker will charge can vary with complexity of loan
    - Needs to be completed within 3 days of application

# III. Broker Duties, etc. (continued)

- Industry Standard of Care
- Credit check
  - Better brokers will use Tri-Merge Credit Bureau
    - This includes all three major repositories – Experian, Equifax and TransUnion
    - This has more “portability” to major lenders
  - Use of single file credit check
    - Less reliable for pre-qualifying borrowers
    - Many brokers use this to defray costs of loans that will not close

# III. Broker Duties, etc. (continued)

- Industry Standard of Care
- Analyzing applicant credit
  - Credit Score
    - Score above 620 (middle score of highest wage earning applicant) will constitute a conforming loan customer – lower score will often still qualify if substantial equity, or if excellent payment history and just overextended credit
    - Score 619 or below – non-conforming borrower – possibility of upgrade but this is rule of thumb
  - Mortgage History
    - Generally – borrower who has been 30 or more days delinquent in last 2 years will not go true conforming
    - Should match mortgage liabilities with properties owned
  - Consumer Credit
    - Should calculate debt to income ratio based on all debts

# III. Broker Duties, etc. (continued)

- Industry Standard of Care
  
- Choosing a lender
  - Broker balances lender with best program for borrower with lender who will compensate borrower for loan
    - Should not put a borrower in a non-conforming loan if they qualify for a conforming one
  - Broker will pre-qualify applicant using Desktop Underwriter (Fannie Mae) or Loan Prospector (Freddie Mac) if conforming
  - Broker will submit basic information to non-conforming lender representative in order to pre-qualify applicant

### III. Broker Duties, etc. (continued)

- Industry Standard of Care
- Collecting Required Documentation From Applicant
  - Desktop Underwriter or Loan Prospector will tell broker documentation level based on feedback
  - For non-conforming loans, the Lender Representative will tell the broker the minimum documentation for submission

### III. Broker Duties, etc. (continued)

- Industry Standard of Care
- Lender Decision / Condition List
  - Lender underwriter will validate initial information that broker provided via DU or LP
  - Lender underwriter will review appraisal/title/income documents for accuracy and authenticity and can ask broker for additional information

## III. Broker Duties, etc. (continued)

- Industry Standard of Care
- Broker Submission of Additional Required Documentation
  - Lender still has opportunity to decline loan based upon information reviewed
  - Lender issues “clear to close”
- Broker Closes Loan

# III. Broker Duties, etc. (continued)

- Policing the Mortgage Broker
- **National Association of Mortgage Brokers** - [www.namb.org](http://www.namb.org)
  - Established in 1973, the National Association of Mortgage Brokers (NAMB) is the only national trade association representing the mortgage broker industry. With 50 state affiliates, and more than 25,000 members, NAMB promotes the industry through programs and services such as education, professional certification and government affairs representation. NAMB members subscribe to a code of ethics and best lending practices that foster integrity, professionalism and confidentiality when working with consumers.

### III. Broker Duties, etc. (continued)

- According to a 2004 study by Wholesale Access Mortgage Research & Consulting, Inc., there are approximately 53,000 mortgage brokerage companies that employ an estimated 418,700 employees and originate more than 50% of all residential loans in the U.S. The mortgage broker industry is regulated by 10 federal laws, five federal enforcement agencies and over 49 state laws or licensing boards. - [www.namb.org](http://www.namb.org)

## III. Broker Duties, etc. (continued)

- NAMB – Code of Ethics
  - Honesty and Integrity
  - Professional Conduct
  - Honesty in Advertising
  - Confidentiality
  - Compliance with the Law
  - Disclosure of Financial Interest

# III. Broker Duties, etc. (continued)

- Pa. Association of Mortgage Brokers – [www.pamb.org](http://www.pamb.org)
  - Continuing Education Requirements
  - Ethical Standards
    - Honesty and Integrity + report fraud/unethical conduct to PAMB
    - Absolute fidelity to client's interest
    - Will not advise on terms not likely to be available
    - Ethics, Grievance and Arbitration Committee

# III. Broker Duties, etc. (continued)

- Pa. Association of Mortgage Brokers
  - Ethics, Grievance and Arbitration Committee
  - The Committee will create a forum to hear and resolve questions and/or complaints regarding business conduct of a mortgage broker. The Committee will attempt to resolve differences of opinion between parties. In this pursuit, the Committee will seek to obtain any information that is pertinent to the issue and provide objective information to both parties.
  - The Committee will develop and implement an objective procedure for handling of questions and/or complaints. The Committee will be accessible to customers and PAMB members to hear questions regarding ethical business practices. The Committee will immediately respond to all questions from customers and PAMB members. Any questions regarding ethical business practices will ultimately be presented to the PAMB Board of Directors for review.

## III. Broker Duties, etc. (continued)

- Very Small Percentage of Pennsylvania Brokers are members of PAMB
- Very Small Percentage of Pennsylvania Brokers are members of NAMB
- Very Small Percentage of Pennsylvania Brokers have E&O Coverage

# IV. Duties of Others in the Mortgage Process

## A. Mortgage Bankers

### ■ Primary duty is compliance with Fannie Mae requirements

- Intent and spirit of all requirements
- Prudent business practices to incorporate any FM changes into their practices
- Volumes of FM guidelines and requirements for bankers to follow
- *We highly recommend that lenders include in their policies for originating new mortgages, refinancing existing mortgages and reviewing all mortgages (retail and wholesale) appropriate safeguards to preclude the possibility of violating our requirements.*

I, 201.01: Lender's Basic Duties and Responsibilities (6/29/07)

## IV. Duties of Others (continued)

- **Mortgage Bankers have to essentially be a watch dog for any irregularities**

Example given by FM:

Instances when originators have engaged in transactions aimed at avoiding the "cash-out" category, when it includes refinancing of a subordinate mortgage not used for purchase. Short term refinance mortgage combining first mortgage and non-purchase money subordinate mortgage into new first mortgage temporarily held by lender, which is immediately refinanced again and characterized as a "limited cash out" refinance sold to FM. This should be a "cash out" and it could be subject to re-purchase by FM.

**I, 201.01: Lenders Basic Duties and Responsibilities (6/29/07)**

## IV. Duties of Others (continued)

- Must make sure adequate staff and facilities to originate and sell quality mortgages, to protect against fraud, misrepresentation or negligence *by any parties involved in the mortgage origination and servicing processes...*
- Before entering into agreement with third party to originate [talking about brokers here], process, underwrite, close, fund or package mortgage delivered to FM" the lender should
  - satisfy itself that originator is capable or producing quality mortgages
  - have fully documented written procedures to ensure that originators are knowledgeable about the lenders origination and selling policies
  - implement measures (such as periodic reviews of originations) to make sure procedures are operational

## IV. Duties of Others (continued)

- Lender is responsible for ensuring that their mortgage and participation interest it sells to FM meets their eligibility requirements
  - Desktop Underwriters – enables lenders to underwrite mortgages faster and more accurately than ever before
  - If do not use DU – can use own criteria – but if this results in higher pricing to compensate for increase risk of borrowers with blemished credit histories – FM will not purchase unless policies are designed to avoid predatory lending practices.

## IV. Duties of Others (continued)

- Monitoring Third Party Originators
- 301.02 - *"We suggest that a lender document its arrangements with third party originators by a contractual agreement that included specific warranties related to the eligibility of mortgages and the third party originator's responsibilities, as well as avenues of recourse that can be taken if the warranties are breached."*

## IV. Duties of Others (continued)

- 301.02 - ..it is particularly important for a lender to employ effective third party risk management procedures:
  - system for evaluating and approving third party originators
  - method for verifying compliance with applicable licensing laws
  - method for confirming compliance with lender contract and lender's contract with FM
  - written quality assurance plan for originator
  - process for resolving quality assurance issues and tracking actions taken
  - requirement for periodic reports on activity and performance issues
  - standards for evaluating originator's performance
  - provisions for suspending or terminating relationship

## IV. Duties of Others (continued)

- 301.02 -additional steps to assist lender in ensuring that the third party originator continues to provide quality mortgage originations ....(at a minimum)...
  - Review of representative samples (could be combination of pre-closing and post-closing audits)
  - Discretionary selection based on location of security properties, LTV ratios, mortgage product types, borrowers' credit scores, originator's past performance, etc.
  - Annual review of originator's financial statements, to determine financial viability and capability of meeting contractual obligations
  - Annual review of performance of mortgages (delinquencies, foreclosures, early payment defaults)

## IV. Duties of Others (continued)

- Pennsylvania's Mortgage Bankers and Brokers and Consumer Equity Protection Act – prohibition against “predatory lending”

*- No lending without due regard to repayment ability. – A lender shall not engage in a pattern or practice of making covered loans based on the consumer's collateral without regard to the consumer's repayment ability, including, but not limited to, the consumer's current and expected income, current obligations as disclosed to the lender by the loan application and the consumer's credit report, employment status and other financial resources other than the obligor's equity in the dwelling which secures repayment of the loan.*

## IV. Duties of Other (continued)

### ■ B. Appraisers

- Pennsylvania - Governed by Rules and Regulations of the State Board of Certified Real Estate Appraisers - 49 Pa. Code Sections 36.1 – 36.53
  - Governs application and approval process
  - Governs continuing education
  - Sets standards of practice – basically comply with USPAP -
    - *Uniform Standards of Professional Appraisal Practice* – from the Appraisal Foundation

# IV. Duties of Others (continued)

## C. Borrowers

### **What do you do with a borrower who is dishonest?**

- secure appropriate documentation
- if something does not seem right – follow up
- stick to the rules – if cannot secure supporting documentation – let the borrower know and forego the loan

# V. Claims Against Brokers

- A. Lenders will seek recourse against
  - 1. Brokers
  
  - 2. Appraisers

## V. Claims (continued)

- B. Borrowers will seek recourse against:
  - 1. Brokers
  - 2. Appraisers
  - 3. Lenders – who will be looking back against the brokers
  - 4. Real Estate Brokers and Agents

# V. Claims (continued)

- C. Typical Complaint / Causes of Action
  - 1. Negligence
  - 2. Negligent Misrepresentation
  - 3. Fraud/Intentional Misrepresentation
  - 4. Breach of Contract
  - 5. Breach of Warranty
  - 6. Unfair Trade Practices and Consumer Protection Law

# V. Claims (continued)

- D. Typical Complaint / Damages
  - 1. Compensatory
  - 2. Punitive
  - 3. Contract
  - 4. Treble Damages Under Unfair Trade Practices and Consumer Protection Law

# VI. Possible Defense Approaches

- Claims by Lenders – Contract Defenses
  - Is the contract valid and enforceable?
    - Is it signed? – E-signature issue?
      - Discovery / Experts?
    - Does it apply to this situation?
    - Arbitration Provision?
    - Jurisdictional Advantage
  - Has lender fulfilled their duties under the contract?
  - Who has final call on approval/funding under terms?
  - Damages

# VI. Defenses (continued)

- Claims by Lenders – Negligence/breach of standard defenses
  - Examine their Fannie Mae obligations – they are still final call on approval, unless broker has funding powers
  
  - Look at Desktop Underwriters – what else should they have done? What red flags are introduced?
    - Take deposition of their underwriters, get their documents
    - If bad appraisal, what steps did they take to ensure accurate
    - If credit risk – any extra steps they took?
    - Is increasing the interest rate always sufficient to obviate need for due diligence?
  
  - Expert Opinion
  
  - What could local representative have done?
  
  - Damages

## VI. Defenses (continued)

- Claims by lenders – Fraud/Misrepresentation Defenses
  - Unless broker actively involved with dishonesty/fraud – examine what steps lender took to uncover truth – if broker should have found it, what responsibility did lender have
  - Becomes a causation issue – what would lender have done if the information provided had been accurate?
  - Have to look at the underlying facts – Fraud Techniques
    - If fraud does become evident – raises a whole new set of issues - need to watch out for fraud by broker/borrower/appraiser

## VI. Defenses (continued)

- **Things to watch out for – common fraud techniques by brokers**
  - Example: Overstating income on “stated deals”
    - Is there one income on “mini-app” and higher one on 1003 sent to lender?
    - Is income reasonable for profession/experience? – can check this out on salary.com or bls.com
    - Is the debt to income ratio too neat – could indicate they “backed into”
    - Are assets listed consistent with income stated?
    - Is high credit risk indicative of person with income stated?
    - If fixed income is SSI, and it is only income – reasonable for previous job

# VI. Defenses (continued)

- Example: Falsifying Supporting Documents
  - Cutting and pasting of income documents
    - Obvious signs of white-out?
    - different fonts?
    - is the copy of W2 proper copy?
  
  - Manufacturing of income documents
    - Are "tax numbers" correct?
    - Are the income hours "round" for hourly job?
    - Has a 4056 been run on borrowers with tax returns?
    - Is the only documentation a hand-filled out VOE?

## VI. Defenses (continued)

- Asset Information
  - Are the fonts correct?
  - Is all the bank statement info consistent?
  - Is it consistent with income?
  - Is the only documentation a hand-written VOI
  - Any change in asses information on 1003?
- Title Information
  - Do the dates on title match application?
  - Are there quick title changes?

## VI. Defenses (continued)

- Example: Asking for Value from Appraiser
  - Appraisal Order Form
    - Does it state a value on it?
    - Are there multiple orders in the file (shopping appraisers)?
- Example: Hiding Straw Borrowers
  - Are there quick changes in title?
  - Does title move from LLC to Borrower?
  - Is Grandma mysteriously moving in?
- Example: Property flipping
  - Huge difference in appraised value form purchase price, with no justification?

## VI. Defenses (continued)

- Example: Occupancy Fraud – Opportunity to make more yield, higher LTV for higher fees
  - Does borrower own higher valued properties?
  - Are there recently bought properties with address differences?

## VI. Defenses (continued)

- Claims by borrowers - negligence/breach of standard claims
  - Look to contract language in Brokerage Business Contract
    - non-liability for lender's acts
    - Litigation provision
    - Good faith estimate disclaimer
    - Title provision
    - Decision provision – borrower has reviewed his personal and financial situation and it is in his best interest to proceed with loan - no reliance on broker advice as to wisdom of doing so

## VI. Defenses (continued)

- Look to comparative negligence
  - Was borrower negligent in providing information?
  - Was borrower less than forthright – minimizing debt/credit problems, overstating income/worth?
- Look to causation issue
- Look to damages
- Expert Opinion

# VII. Trends

- The Lawsuits and Impact of Popular Culture

1. Recent article on the MSN Website "Should Your Sue Your Lender?"

- sets forth in great detail situations where you may have a claim

- sets forth potential wrongdoings by broker that could form basis for suit

## VII. Trends (continued)

Potential bases for suit by borrowers:

- broker falsified income
- broker hid his/her fees
- not giving good faith estimate/accurate HUD-1
- giving sub-prime loan when qualified for better loan
- not clear on tax and escrow payments
- broker double dipping with a YSP (yield spread premium)
- "no doc" loans

## VII. Trends (continued)

2. Google search of "sub-prime loan litigation" turns up countless sites with lawyers asking potential clients if they feel they've been defrauded by their lender or broker
3. Daily newspaper and internet news articles about the re-fi "crash"
4. Impact of market trends on economy in general
  - Re-fi "crash" =
  - fewer no-doc / higher risk loans =
  - fewer low to low- middle houses being financed/sold =
  - decrease in upgrades to newer/new homes =
  - building industry taking a hit

## VIII. Recent Decisions

- **Commercial Law/Mortgages** - Mortgagors brought action against lender, alleging that lender charged excessive, and thus unreasonable, title insurance rate which the lender failed to disclose as required by the Truth in Lending Act. The mortgagors contended at trial that the loan in part refinanced a prior mortgage debt, and the lender improperly charged the basic rate rather than the lower refinance rate. The bankruptcy court held, however, that the title insurance rate charged by the lender was not shown to be unreasonable or that the finance charge disclosed by the lender was inaccurate. There was no credible evidence that the mortgagors notified lender of the existence of prior insurance, knowledge of a prior mortgage loan did not place the lender on notice of such prior insurance, and the lender had no duty to inquire. Further, the prior policy failed to identify the property to indicate that the policy covered the same property. **Glauser v. Deutsche Bank Nat'l Trust Co., 365 B.R. 531 (2007).**

## VIII. Recent Decisions

- **Mortgage Brokers** - Purchasers sued defendants, a mortgage broker and a lender, and alleged breach of contract, fraud, violations of Pennsylvania's Unfair Trade Practices and Consumer Protection Law, and negligent misrepresentation. The lender worked with the broker to finance the purchasers' home. Purchasers alleged that they lost the opportunity to purchase the home after the broker, who had promised the purchasers that the lender would provide mortgage financing on the day of closing, failed to even show up at the closing. As there was no genuine issue of material fact that the broker was not acting as the lender's agent in its role as mortgage broker, none of the broker's conduct could be attributed to the lender. The question was whether the broker exercised apparent authority to bind the lender to a contract with the purchasers. The Court found it was undisputed that the broker was free to shop the loan application, just as an insurance broker was free to shop an insured's application to different insurers. But the analogy of mortgage broker cases to insurance broker cases did not help the purchasers because if mortgage brokers were like insurance brokers, as the purchasers suggested, they were the agents of the mortgagors and not the mortgagees. Finally, agency by estoppel and agency by ratification did not apply. **Hawthorne v. Am. Mortgage Inc., 489 F. Supp. 2d 480 (E.D.Pa., 2007).**

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# Appendix

- Blank Uniform Residential Loan Application
- Countrywide Wholesale Broker Agreement
- Loancity E-Broker Agreement
- Mortgage Brokerage Business Contract – 2 sample forms
- Proposed New Regulations – Pa. Dept. of Banking
- Sample Broker Processing Checklist
- Sample Appraisal Order Form
- Sample Desktop Underwriter Report (Fannie Mae Underwriting Findings)
- Sample Good Faith Estimate
- Sample HUD-1
- Sample Uniform Underwriting and Transmittal Summary

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