Financial Services Update
February 11, 2015

HIGHLIGHTS

Federal Regulatory Developments

HUD Issues Mortgagee Letter Addressing Program Eligibility for HUD-Insured Housing Programs Under HUD's Equal Access Rule

HUD Issues Revised Prepayment Disclosure Statement

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Litigation Developments

RFC Cases in New York and Minnesota Move Forward

US Supreme Court Justices Issue Rare Call For Petitions on Rule of Lenity's Application to Hybrid Civil and Criminal Statutes – An Issue that Is Likely to Gain Traction as the Government Continues to Aggressively Pursue Novel Interpretations of RESPA, the False Claims Act, and FIRREA

WBK News

Mitch Kider will address Regulatory & Enforcement Developments during the Regional Lenders Roundtable Meeting on February 11 in Scottsdale, AZ. For more information contact Mitch at kider@thewbkfirm.com.

Jack Konyk will participate on a panel with state and federal regulators exploring the state and direction of mortgage supervision at the NMLS User Conference on February 18 in San Diego, CA. For more information contact Jack at konyk@thewbkfirm.com.

Mitch Kider will lead a panel session titled "What to Expect from Enforcement Actions" at MBA's National Mortgage Servicing Conference on February 24 at 2:00 pm in Dallas, TX. For more information and to register go to: http://events.mortgagebankers.org/Servicing2015/default.html.

Jim Brodsky has joined the Board of Directors of the Community Preservation and Development Corporation, a 25 year old regional non-profit real estate developer of and resident services provider to multiple affordable housing communities stretching from Richmond, VA through and including the District of Columbia to Baltimore, MD, serving almost 10,000 residents in about 5,000 residential apartments with a total development value in excess of $500 million. Jim also serves as a Member of the Board (and formerly as Lead Director) of MFA Financial, Inc., a New York-based NYSE-listed $11 billion residential mortgage REIT primarily engaged in investing in RMBS on a leveraged basis. For more information contact Jim at brodsky@thewbkfirm.com.

SUMMARIES

Federal Regulatory Developments

HUD Issues Mortgagee Letter Addressing Program Eligibility for HUD-Insured Housing Programs Under HUD's Equal Access Rule

On February 6, 2015, FHA issued Mortgage Letter 2015-05 (ML 2015-05), which is intended to increase awareness of the requirements of HUD's Equal Access Rule for actual or perceived discrimination based on sexual orientation, gender identify, or marital status.

HUD published "Equal Access to Housing in HUD Programs Regardless of Sexual Orientation or Gender Identity" (the "Equal Access Rule") on February 3, 2012. The rule made certain changes to HUD's General Regulations and FHA Regulations to prohibit discrimination based on sexual orientation, gender identity, or marital status. For example, with respect to HUD's general program requirements, found at 24 CFR § 5.105(a)(2), the rule added a provision that a determination for eligibility for housing assisted by HUD or subject to an FHA-insured mortgage must be made in accordance with the eligibility requirements provided for such program by HUD, and such housing must be made available without regard to actual or perceived sexual orientation, gender identity, or marital status. The rule also added that no owner or administrator of HUD-assisted or HUD-insured housing, approved lender in an FHA mortgage insurance program, or other recipient of HUD funds may inquire about sexual orientation or gender identity of an applicant for, or occupant of, HUD assisted or HUD-insured housing for purposes of determining eligibility or otherwise making such housing available. However, the rule permits inquiries into sex in certain limited circumstances. The rule also revised certain definitions found in 24 C.F.R. § 5.100, including "family," "gender identity," and "sexual orientation."

HUD noted in ML 2015-05 that the rule does not create any additional protected classes under the Fair Housing Act or any other civil rights law. However, HUD notes that although the Fair Housing Act does not expressly include sexual orientation, gender identity, and marital status as protected classes, a lesbian, gay, bisexual or transgender person's experience with sexual orientation or gender identity housing discrimination may still be covered by the Fair Housing Act's prohibition on discrimination based on sex. HUD also indicated it may refer complaints regarding protected classes to appropriate state and local fair housing enforcement agencies, as many states and local jurisdictions prohibit housing discrimination based on sexual orientation, gender identify, and/or marital status.

These changes will be incorporated into HUD's Single Family Housing Policy Handbook 4000.1, which will be effective June 15, 2015.

ML 2015-05 can be found at the following link:
http://portal.hud.gov/hudportal/documents/huddoc?id=15-05ml.pdf.

HUD Issues Revised Prepayment Disclosure Statement

HUD recently issued a revised Model Prepayment Disclosure Statement to align the language of this disclosure with the final rule that was previously issued by HUD and that eliminated post-payment interest charges for FHA loans. HUD's final rule prohibited the practice of imposing interest charges on consumers for the balance of the month in which the consumer prepays the loan in full. This final rule became effective on January 21, 2015.

FHA-approved mortgagees may use the Model Prepayment Disclosure Statement to comply with the obligation to provide the borrower annually with a written disclosure of the amount outstanding on the loan as well as a description of the requirements that the borrower must fulfill upon prepayment of the loan. For FHA loans closed on or after January 21, 2015, the disclosure now contains a statement: "You will only be required to pay interest up to the date the prepayment is made."

The revised model disclosures include the annual disclosure notice for FHA loans insured before August 2, 1985, FHA loans insured on or after August 2, 1985 and closed before January 21, 2015, as well as FHA loans closed on or after January 21, 2015. These disclosures can be found at:
http://portal.hud.gov/hudportal/documents/huddoc?id=SFH_FHA_INFO_15-08.pdf.

FHFA Proposes New Minimum Financial Requirements for Non-Depository Servicers

On January 30, 2015, the FHFA announced proposed enhanced minimum financial requirements for net worth, capital ratio and liquidity criteria for Fannie Mae and Freddie

Mac servicers. The proposal revises the minimum net worth requirements for all servicers, and revises the capital ratio standards and imposes new minimum liquidity standards for non-depository servicers. Depository institutions will be required to follow the current regulatory standards in place for such institutions with regard to the minimum requirements for capital ratios and liquidity. The stated purpose of these requirements is to ensure the safe and sound operation of Fannie Mae and Freddie Mac, further FHFA's goal of fostering liquid, efficient, competitive and resilient national housing finance markets, and provide greater transparency, clarity and consistency to industry participants and other stakeholders.

Specifically, FHFA proposes the following requirements:

- **Minimum net worth**: $2.5 million plus 25 basis points of unpaid principal balance (UPB) for total loans serviced
- **Minimum capital ratio**: Tangible Net Worth/Total Assets of at least 6%
- **Minimum liquidity**:
  - 3.5 basis points of total agency servicing (i.e., the sum of mortgages the Servicer serviced for Fannie Mae, Freddie Mac, Ginnie Mae) ***plus***
  - Incremental 200 basis points of total nonperforming agency servicing in excess of 6% of the total agency servicing UPB

Allowable assets for liquidity may include the following:

- Cash and Cash Equivalents (Unrestricted)
- Available for Sale (AFS) or Held for Trading (HFT) Investment Grade Securities:
  - Agency MBS
  - Obligations of GSEs
  - US Treasury Obligations
- Unused/available portion of committed servicing advance lines (a quarterly CFO certification of this information will be required at this time)

While the minimum net worth requirement is unchanged from current requirements, the 25 basis points is based on all loans serviced, not just those serviced for a particular agency. Similarly, while the proposed capital ratio is the same as it is today, the tangible net worth definition is revised to mean the total equity less receivables due from related entities less goodwill and other intangibles less pledged assets (instead of the current definition which bases the ratio on the net worth used to meet the current net worth requirement). The minimum liquidity requirement is a new standard for non-depository institutions.

Note that, for subserviced loans, the minimum financial requirements would apply to the master servicer, not the subservicer.

FHFA, Fannie Mae and Freddie Mac will engage with servicing industry participants, regulators and other stakeholders to obtain their feedback and improve their understanding prior to finalization. FHFA anticipates finalizing these requirements in the second quarter of 2015, and anticipates that the requirements will be effective six

months after they are finalized. Once in effect, Fannie Mae and Freddie Mac will have discretion to take appropriate action (including termination) if a servicer does not comply with the new requirements.

Litigation Developments

RFC Cases in New York and Minnesota Move Forward

Residential Funding Company, LLC ("RFC") was one of the nation's larger sub-prime mortgage loan lenders and securitizers leading up to the housing market crash, but it succumbed to the financial crisis, entering bankruptcy in 2012. In December 2013, RFC settled most of the claims against it, and its bankruptcy successor has engaged in an extensive litigation campaign to recover from the lenders that sold mortgage loans to RFC. Most of these lawsuits have been brought in, or transferred to the U.S. District court in Minnesota, but some of RFC's litigation is pending as adversary proceedings in its bankruptcy case, in the Southern District of New York. On February 3, 2015, the bankruptcy judge granted in part and denied in part the motions to dismiss filed by mortgage loan originators.

The defendants argued dismissal was proper because RFC long ago sold its rights to the loans and no longer had standing to assert claims. The defendants further argued that RFC failed to provide them with notice and the opportunity to cure the alleged breaches prior to filing suit, which the defendants alleged was required by the parties' contracts. The Bankruptcy Court rejected these arguments as raising factual issues not appropriately determined on a motion to dismiss.

The defendants also argued that RFC's claims for indemnification should be barred by its own fraud and securities law violations as a matter of public policy. The Bankruptcy Court likewise rejected these arguments, stating that RFC settled those allegations in its bankruptcy without admitting liability.

The defendants' sole winning argument was based upon statute of limitations grounds. The Bankruptcy Court granted the defendants' motions to dismiss as to RFC's breach of contract claims made on loans originated outside the six-year statute of limitations period. The Bankruptcy Court found that RFC had only pled facts alleging breaches by the defendants at the time of origination, such as "income misrepresentation, employment misrepresentation, appraisal misrepresentations or inaccuracies, undisclosed debt, and missing or inaccurate documents, among others." The Bankruptcy Court therefore found that RFC's breach of contract claims accrued on the closing date of the loans. The Bankruptcy Court noted that judges in the approximately 70 cases brought by RFC in Minnesota had split on the issue, but that it was convinced that breach of contract claims on loans sold to RFC outside the statute of limitations period were untimely.

Such splits in the decisions of the approximately 70 RFC cases in Minnesota are less likely to result following an order entered in each of those cases on January 27, 2015.

The order consolidates those cases before District Court Judge Susan Richard Nelson and Magistrate Judges Hildy Bowbeer and Jeffrey J. Keyes for purposes of all pretrial matters except summary judgment motions. A pretrial order entered on February 2, 2015 sets consolidated monthly status conferences for all the consolidated RFC cases going forward.

Weiner Brodsky Kider regularly represents mortgage lenders and servicers throughout the United States, in connection with claims for mortgage loan repurchase and indemnification.

US Supreme Court Justices Issue Rare Call For Petitions on Rule of Lenity's Application to Hybrid Civil and Criminal Statutes – An Issue that Is Likely to Gain Traction as the Government Continues to Aggressively Pursue Novel Interpretations of RESPA, the False Claims Act, and FIRREA

Justices Scalia and Thomas of the United States Supreme Court recently issued a rare pronouncement of an issue they would like to see come before the high court: whether or not courts should defer to executive agencies' interpretations of statutes with criminal repercussions, such as Section 8 of RESPA.

In denying the petition for review in *Whitman v. United States*, a case involving securities law violations, Justices Scalia and Thomas issued a published statement regarding the application of the Rule of Lenity to statutes with both civil and criminal repercussions. The Rule of Lenity instructs that courts should construe ambiguities in criminal laws in favor of the defendant, and not the government. Some statutes have both criminal and civil penalties, and courts have struggled with whether or not to defer to an executive agency's interpretation of such statutes in the prosecution of administrative enforcement actions. Pursuant to Supreme Court authority after *Chevron USA Inc., v. Natural Resources Defense Council*, courts must defer to an executive agency's regulations interpreting ambiguous statutes.

Justices Scalia and Thomas appear to believe the Rule of Lenity should apply in such situations, and noted that they would be amenable to granting petitions for review on that issue in the future. In doing so, Justice Scalia was characteristically colorful, analogizing the executive agencies that attempt to interpret criminal laws in their favor to King James I's attempts to create new crimes by royal command, but noting that King James did not have the benefit of *Chevron* deference.

Notably, Justices Scalia and Thomas relied upon the Sixth Circuit Court of Appeals' decision in *Carter v. Welles-Bowen Realty, Inc.*, in which the Sixth Circuit rejected the CFPB's use of HUD's 1996 Policy Statement on Sham Affiliated Business Arrangements. The Sixth Circuit rejected the 1996 Policy Statement because it was inconsistent with the statutory language of RESPA, and further noted that the Rule of Lenity requires that executive agencies must construe hybrid civil and criminal statutes in favor of the defendant, even when only pursuing civil remedies.

This is an important development for the financial services industry, particularly because of the CFPB's and other government agencies' aggressive use and interpretation of multiple hybrid statutes, including RESPA, the False Claims Act, and the Financial Institution Reform, Recovery, and Enforcement Act ("FIRREA"). If the Supreme Court were to rule conclusively that the Rule of Lenity applies to such statutes, then aggressive interpretations of those statutes would be more difficult for the government to pursue.

Weiner Brodsky Kider regularly represents mortgage lenders, brokers, and servicers throughout the United States, in defense of alleged violations of RESPA, the False Claims Act, and FIRREA.