UPDATE: CASE LAW AND RECENT DEVELOPMENTS

INTRODUCTION

Foreclosure law, like any other area of law, is always evolving. This portion of today's seminar includes a round-up of both recent Minnesota foreclosure case law, as well as recent federal regulatory action affecting mortgage lending and servicing policies and procedures. In today's regulatory environment, lenders must, perhaps now more than ever before, be sure to follow the proper steps at every stage of the lending process in order to ensure a smooth road to foreclosure in the event of loan default.

CASE LAW

Otremba v. CitiMortgage, Inc., No. 13-871, 2014 WL 4639778 (D. Minn. Sep. 16, 2014).

The court has clarified that Minnesota borrowers have standing to bring suit contesting the validity of the foreclosure sale of their residence based on allegations that the newspaper utilized for publication of the notice of foreclosure sale was not likely to give notice in the area where the property was located.

Montero v. Bank of America, N.A., 2014 WL 562506 (D. Minn. Feb. 13, 2014).

This case states a Minnesota mortgagor may not object to the foreclosure of a mortgage based on the alleged invalidity of a prior assignment of the mortgage (the only parties with standing to object to an assignment of a mortgage are the parties to the assignment).

Geneva JPM 2003-PM1, LLC v. Geneva FSCX I, LLC, A13-0718 (Minn. App. March 3, 2014).

The court held in this case that the amount that can be collected on a guaranty, absent contractual language to the contrary, depends on the balance of the debt at the time the creditor invokes its rights under the guaranty. In other words, a sale of mortgaged property will reduce the mortgage debt (and any related guaranty absent contractual language to the contrary) by the amount of the purchase money.

First Resource Bank v. DJ Land Development, LLC, A13-2158 (Minn. Ct. App. June 2, 2014).

The court found in this case that the legislature did not intend Minn. Stat. § 582.30, subd. 3 to apply to foreclosure actions involving either property that is capable of being used in agricultural production, even though it was not used for that purpose, or property that was previously used in agricultural production by an unidentified person.

Rogers v. Bank of America, N.A., No. 13-CV-1698, 2014 WL 2968900 (D. Minn. July 1, 2014.

In this case, the court held that a mortgagor may not object to the foreclosure of a mortgage based on a claim that the assignment of mortgage documents was in violation of pooling and securitization agreements between financial institutions (only the financial institutions who are parties to the pooling and securitization agreements have standing to file suit for violation of such agreements).

Drews v. Federal National Mortgage Association, No. A13-1135 (Minn. Ct. App. July 21, 2014).

If a foreclosing party produces evidence of proper personal service of notice of a foreclosure sale on the person in possession and occupation of the mortgaged premises under Minn. Stat. § 580.03, the burden of production shifts to the party challenging service to produce clear and convincing evidence that service was improper.

OTHER RECENT DEVELOPMENTS

The Mortgage Servicing Rules

The Dodd-Frank Wall Street Reform Act and Consumer Protection Act ("Dodd-Frank Act") amended both the Real Estate Settlement Procedures Act ("RESPA"), which is implemented by Regulation X, and the Truth in Lending Act ("TILA"), which is implemented by Regulation Z, in 2010. Both these Acts address the servicing of mortgage loans. The Consumer Financial Protection Bureau ("CFPB") is the federal agency responsible for overseeing all federal financial laws that specifically protect consumers, including RESPA and TILA, among others. In January 2013, the

CFPB issued rules to implement the Dodd-Frank amendments (the "Mortgage Servicing Rules") which took effect on January 10, 2014.

Although this seminar covers many of the provisions of the Mortgage Servicing Rules, it is not meant to be a comprehensive summary of these rules. These materials' focus is on those provisions that intersect most closely with mortgage servicers' foreclosure processes on closed-end consumer credit transactions secured by a dwelling (referred to herein as "mortgage loans" for convenience purposes). It should be noted that the Mortgage Servicing Rules apply differently in certain respects to creditors or assignees of consumer mortgage loans and to different types of mortgage loans, such as open-end lines of credit or home equity lines of credit, reverse mortgages, timeshare loans, and fixed-rate loans that have coupon books.

As is the case in various new mortgage foreclosure regulations, certain servicers are exempt from some provisions within the Mortgage Servicing Rules as "small servicers."[1] A servicer's eligibility for this small servicer exemption is determined each calendar year. Should a servicer cross the 5,000-loan threshold or take on a loan it did not own or did not originate, the Mortgage Servicing Rules allow that servicer 6 months to comply with any requirements which it may previously have been exempt from as a small servicer. If a servicer services any consumer loans which it does not own or did not originate, it does not qualify for the small servicer exemption, no matter how few mortgage loans it services per year.

The Mortgage Servicing Rules generally require servicers to tailor their policies and procedures to achieve specific enumerated objectives[2] and also requires servicers to retain records of all actions on its mortgage loans until 1 year has passed since the mortgage was either discharged or transferred[3]. These rules also require servicers to maintain all loan transaction data, all security instruments that establish mortgage liens, and any notes created by personnel in such a manner that the servicer could accommodate compilation of a servicing file within 5 days of a request for the same, if necessary.[4]

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[1] § 1026.41(e)(4) (Unless otherwise stated herein, all footnotes herein are cites to various sections of United States Code, Title 12.)
[2] § 1024.38(b)(1) – (5).
[3] § 1024.38(c)(1).
[4] § 1024.38(c)(2).

Generally, these rules also require servicers to make good faith efforts to establish live contact with mortgage loan borrowers whose loans are secured by said borrowers' personal residence by the 36th day of their delinquency.[5] For the purposes of this rule, a mortgage loan is considered delinquent on the day a payment sufficient to cover principal, interest, and escrow, if applicable, is due and unpaid for a given billing cycle, regardless of any grace period that may be allowed before a late fee is assessed. Additionally, servicers must provide written notice to delinquent borrowers of loss mitigation options that may be available, that includes housing counseling information, by the 45th day of their delinquency.[6] The Mortgage Servicing Rules also require servicers to assign a specific individual or team to each delinquent borrower by the 45th day of their delinquency, if not sooner. That specific individual or team is to then remain assigned to that specific delinquent borrower until that borrower makes 2 consecutive payments without incurring a late charge.

The Mortgage Servicing Rules have put various guidelines in place relating to the proper evaluation of and response to loss mitigation applications received in relation to mortgage loans secured by a borrower's principal residence, in addition to the commencement and continuation of foreclosure.[7] These new rules do not require servicers to use any certain evaluation criteria or to offer specific loss mitigation options to specific borrowers. However, many different types of contact can qualify as a loss mitigation application under the Mortgage Servicing Rules, including an oral assertion from a borrower indicating interest in being evaluated for loss mitigation options, if that assertion contains any information that might be considered in evaluating an application.

Even if no loss mitigation application has been received, the first notice or filing required to begin the foreclosure process cannot be made or filed until the borrower is at least 120 days delinquent.[8] This restriction on notices or filings applies to any notices required by law to accelerate a mortgage loan. Likewise, no motion for foreclosure judgment or order of sale can be made, and no

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[5] § 1024.39.
[6] The Mortgage Servicing Rules' model language for this written notice can be found in APPENDIX MS-4 TO PART 1024.
[7] § 1024.41.
[8] § 1024.41(f)(1).

foreclosure sale can actually be conducted if a complete loss mitigation application is submitted more than 37 days before any scheduled foreclosure sale.[9]

The Mortgage Servicing Rules also set specific guidelines regarding how to properly respond to error notices or information requests relating to the servicing of a mortgage loan.[10] These guidelines, among other things, require servicers to respond to notices of error received relating to mortgage loans that have foreclosure sales scheduled within 30 days or prior to the scheduled foreclosure sale, whichever is earlier, as long as the notice is received more than 7 days prior to the scheduled sale date. Servicers do not need to respond to error notices received less than 7 days prior to a scheduled foreclosure sale date.

There is a private right of action available for violations of these rules in that consumers may enforce the loss mitigation procedures of the Mortgage Servicing Rules pursuant to Section 6(f) of RESPA.[11] In addition, the Dodd-Frank Act authorizes the CFPB to enforce the Mortgage Servicing Rules directly either via litigation or enforcement actions. So far, the CFPB has taken action against at least one bank for violation of the Mortgage Servicing Rules for, among other things, improper processing of loss mitigation applications and improper denials or delays of loan modification requests. The penalty imposed included a payment of $27.5 million to the bank's victims and a $10 million fine.

<u>HOEPA Rules</u>

In January 2013, the CFPB also issued a new rule amending Regulation Z that resulted in changes to the Home Ownership and Equity Protections Act, otherwise known as HOEPA ("2013 HOEPA Rule"). HOEPA has always contained high-cost coverage tests for refinances and closed-end home equity mortgage loans, required special disclosure requirements and restrictions on terms, and offered enhanced remedies for violations to consumers with these types of loans. The 2013 HOEPA rule expands the scope of HOEPA coverage to include purchase-money mortgages and open-end credit plans (i.e., HELOC's).[12] This new rule generally increases the number of loans

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[9] § 1024.41(g).
[10] § 1024.35; 1024.36.
[11] § 2605(f).
[12] § 1026.32(a)(1).

subject to HOEPA. The 2013 HOEPA Rule applies to all applications received on or after January 10, 2014.

It's important to note that HOEPA coverage is still limited to only those loans secured by a borrower's principal dwelling whether that dwelling is titled as real or personal property, and has not expanded far enough to include reverse mortgages, (initial) construction loans, or loans directly financed by HFA or USDA.[13] The 2013 HOEPA Rule also implements Dodd-Frank Act homeownership counseling amendments, which although included in the 2013 HOEPA Rule, actually apply to all creditors regardless of whether or not they make high-cost mortgages and, where applicable, must be adhered to on top of the high-cost mortgage counseling requirements.[14]

The 2013 HOEPA Rule changes the coverage tests that determine whether a transaction that is not exempt from HOEPA coverage is considered a "high cost mortgage" and is, thus, subject to the HOEPA requirements and restrictions.[15]

The APR Cost and Index test is also changed by this new rule.[16] A transaction is a high-cost mortgage under the new test if its closing date APR exceeds the APOR as of the date the interest was set. The test now has different thresholds for more types of transactions (e.g., first-lien vs. junior-lien, more vs. less than $50,000, and secured by real vs. personal property). A transaction's interest rate for HOEPA purposes is calculated according to special rules for HOEPA coverage that are determined by whether the transaction rate is fixed or variable[17], and is then compared to the APOR index for a "comparable transaction."[18]

The HOEPA High-Cost Points and Fees test has also changed to set different thresholds for different sized loans[19]. These thresholds are set to adjust annually for inflation. The 2013 HOEPA Rule both adds and removes certain items from the points and fees to be considered in HOEPA

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[13] § 1026.32(a)(2).
[14] § 1026.36(k); 1024.20; 1026.34(a)(5)(i) to (vi).
[15] § 1026.32(a)(1).
[16] § 1026.32(a)(1)(i) and comments 32(a)(1)(i)-1 through 3 and 32(a)(1)(i)(B)-1).
[17] § 1026.32(a)(3) and comments 32(a)(3)-1 to -5).
[18] Comment 32(a)(1)(i)-(1).
[19] § 1026.32(a)(1)(ii).

calculations, which are generally limited to those amounts known at or before consummation (closed-end transactions) or account opening (for open-end credit lines), unless the rule specifies otherwise.[20]

The 2013 HOEPA rule requires both the inclusion of prepayment penalties in the points and fees calculation, as well as imposes a separate Prepayment Penalties Coverage test, which specifically defines "prepayment penalty" for coverage purposes.[21] If met, a loan can be considered a high-cost mortgage based on the prepayment penalty charged alone.[22] Prepayment penalties are generally banned for high-cost mortgages, subject to certain narrow exceptions.[23]

The 2013 HOEPA Rule retains the various restrictions on loan terms for high-cost mortgages[24] and notably adds an additional exception to the general ban of balloon payments that allows for balloon payments on certain short-term bridge loans.[25] The rule additionally continues to require certain high-cost mortgage disclosures which now vary depending on whether the underlying loan is a closed-end loan or a HELOC.[26] The 2013 HOEPA Rule also adds a new section to the HOEPA Rule which allows a creditor or assignee who may have failed to comply with a high-cost mortgage requirement to not be deemed to have violated such requirement, if the creditor or assignee was acting in good faith and satisfies certain specified conditions.[27]

RESPA-TILA

The CFPB, in accordance with the Dodd-Frank Act's mandate for an integration of the mortgage loan disclosures under TILA and RESPA, also published rules which combine the disclosures consumers receive in connection with applying for and closing on a mortgage loan under TILA and RESPA ("TILA-RESPA rule"). A new form, the Loan Estimate, will replace the Good Faith Estimate (often referred to as "GFE") and the initial Truth-in-Lending disclosure and will need to be provided to consumers within 3 business days of loan application submission. An integrated

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[20] § 1026.32(b)(1) and (2).
[21] § 1026.32(b)(6)(i) and 1026.32(b)(6)(ii).
[22] § 1026.32(a)(1)(ii).
[23] § 1026.32(d)(7).
[24] § 1026.32(d).
[25] § 1026.32(d)(1)(B).
[26] § 1026.31 and 1026.32(c); Model forms and clauses can be found in APPENDICES G AND H TO PART 1026.
[27] § 1026.31(h).

Closing Disclosure form will replace the HUD-1 and final Truth-in-Lending disclosure and will need to be provided to consumers at least 3 business days before loan consummation.

The TILA-RESPA rule is effective August 1, 2015 and will apply to all applications on most closed-end consumer mortgages[28] received by creditors on or after that date.[29] Note that the new Loan Estimate includes the disclosure now required under the new required under the new High-Priced Mortgage Loan Appraisal Rule on closed-end credit, which is discussed below, and the TILA-RESPA rule is consistent with the current rules under TILA, in that they do not apply to loans made by a person or entity that makes five or fewer mortgages in a calendar year.

Escrow

Previously to the issuance of the TILA-RESPA rule, the CFPB issued a rule amending TILA which both lengthened the time an escrow account[30] must be maintained for higher-priced mortgage loans[31] secured by a first lien on a principal dwelling, as well as exempted certain transactions from TILA's general escrow requirement ("TILA Escrow Rule"). The TILA Escrow rule went into effect for applications received on or after June 1, 2013. Its requirements were amended again on September 13, 2013 to reach its final form that applies to all applications received on or after January 1, 2014.

Under the TILA Escrow Rule, an escrow account now must be established and maintained on a higher-priced mortgage loan[32] secured by a first lien on a principal dwelling[33] for at least 5 years (up from 1 year), regardless of loan-to-value ratio, until either the underlying debt obligation is terminated or the borrower requests the account be cancelled. Only those customers who have paid down the principal balance of their underlying debt obligation to an amount less than 80% of the original value of the property securing the underlying debt obligation and who are not delinquent or in default can have their required escrow account terminated at their request under this rule.

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[28] § 1026.19(e) and (f).
[29] § 1026.19(e)(2).
[30] § 1024.17(b).
[31] § 1026.35(a)(1).
[32] § 1026.35(a)(1).
[33] § 1026.2(a)(19).

The TILA Escrow Rule also expands an exemption from the requirement to exempt, not just condominiums, but all types of planned unit developments or other common interest communities from the requirement for escrow of property insurance premiums where homeowners must participate in governing associations that are required to purchase master insurance policies on their dwellings. The rule also exempts certain small creditors that predominantly serve consumers in rural or underserved counties.[34]

Home Mortgage Disclosure Act (HMDA)

The Dodd-Frank Act also transferred HMDA rulemaking authority from the Federal Reserve Board to the CFPB and, as such, the CFPB is likewise taking steps to further develop HMDA's data and reporting requirements in accordance with another Dodd Frank Act directive. CFPB's proposed rule, which was initially proposed in July 2014, delineates both certain additional information the CFPB believes should be reported, as well as reporting process simplifications to, among other things, align the HMDA data requirements with current industry data standards. The final rule is set to go into effect in July 2015.

In addition to the current reporting requirements, the CFPB's proposed rule would require the reporting of such additional information as property value, loan term, total points and fees, the duration of any teaser or introductory interest rates, and the applicant's or borrower's age and credit score, in addition to more information about underwriting and pricing (i.e., applicant's debt-to-income ratio, loan interest rate, total discount points charged). In various commentary to its rule, the CFPB has indicated its goal behind these proposed additional reporting requirements is the overall improvement of HMDA data collected in light of all the changes that have occurred in the mortgage loan market since the current rules' enactment.

With an eye towards simplifying the HMDA reporting requirements, the CFPB's proposed rule also suggests a new standardized reporting threshold that would apply equally to both depository and non-depository institutions, as well as ease reporting requirements for smaller depository institutions. The CFPB's proposed rule also covers suggested improvements to the electronic

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[34] 1026.35(b)(2)(iii)(A) and 1026.35(b)(2)(iv)(B).

reporting process and data access, both to make the data submission process more efficient for financial institutions, as well as to improve how the public can more securely use HMDA data, as well as better use HMDA data altogether.

The CFPB separately issued its annual adjustment to the asset-size exemption threshold, as required, which was increased from $43 million to $44 million to exempt financial institutions with assets of $44 million or less from the data collection requirements in 2015.

Appraisal

The regulatory boom which followed the housing bubble burst also affected the appraisal process for mortgage lenders.

Specifically the CFPB has also amended Regulation B, which implements the Equal Credit Opportunity Act ("ECOA"), and now requires lenders to automatically and promptly provide free copies of all appraisals and any other written valuation[35] prepared in conjunction with a loan application (for either new credit or a loss-mitigation transaction) promptly upon completion of the appraisal/valuation when that loan (closed-end or open-end and for business or consumer purposes) is to be secured by a first lien on a dwelling[36], regardless of whether credit is ultimately extended or denied unless the loan applicant properly waives the timing requirement[37] ("ECOA Valuations Rule"). Likewise, lenders must be sure to inform loan applicants of their right to receive copies of any appraisal promptly[38] and cannot charge for copies (although there is still no prohibition against charging for preparing the appraisal itself).[39]

Additional requirements apply to appraisals on certain[40] higher-priced mortgage loans[41] based on other Dodd-Frank Act amendments to TILA ("Higher-Priced Mortgage Loans Appraisal Rule") that relate to disclosure and other requirements on higher-priced mortgage loans under the CFPB's Higher-Priced Mortgage Loans Appraisal Rule, which is part of Regulation Z. Higher priced

[35] § 1002.14(b)(3).
[36] § 1002.14(c).
[37] § 1002.14(a)(1).
[38] The CFPB's model language for this written notice can be found in FORM C-9 IN APPENDIX C TO PART 1002.
[39] § 1002.14(a)(3).
[40] § 1026.35(c)(2).
[41] Loans secured by manufactured homes are exempt from these rules until July 18, 2015.

mortgage loans, for this rule's purposes, are generally loans secured by a principal dwelling (whether the loan is a first- or subordinate-lien mortgage) with an interest rate above particular limits[42]. The Higher-Priced Mortgage Loans Appraisal Rule requires lenders to use licensed/certified appraisers who must physically visit the property to view the interior and certify the appraisal complies with uniform standards of both appraisal practice and FIRREA regulations[43], as well as comply with the automatic and prompt provision requirements of the ECOA Valuations Rule discussed above. In addition, supplementary independent appraisals[44] need to be obtained under the Higher-Priced Mortgage Loans Appraisal Rule when the loan involves certain[45] purchases of a flipped[46] property that exceeds the rule's specified price thresholds.

Although appraisal review can be outsourced to a third party, it is important to remember that an outsourcing lender remains responsible for any violation by the third party of either of these rules.

CONCLUSION

In today's highly regulated mortgage lending climate, it is important to keep an eye on not only updates to case law and judicial interpretations of state foreclosing statutes, but also the most current regulations affecting all stages of the mortgage lending process to ensure a smooth road to a valid and effective foreclosure upon loan default.

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[42] § 1026.35(a)(1); cf. § 1026.35(c)(2) (which states loans exempted from the Higher-Priced Mortgage Loans Appraisal Rule).
[43] A statutory list of steps lenders can take to ensure an appraisal meets these requirements can be found in APPENDIX N TO PART 1026.
[44] § 1026.35(c)(4)(ii)-(iv).
[45] § 1026.35(c)(4)(vii).
[46] 15 U.S.C. § 1639h(b)(2); 12 U.S.C. § 1026.35(c)(4)(i).