

Legal analysis to guide the mortgage industry and protect its interests.

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## Suitability is Alive and Well

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The Massachusetts Supreme Judicial Court recently affirmed a decision that, per the Massachusetts Attorney General, “sets precedent” for suitability. The Massachusetts high court affirmed a lower court’s injunction preventing a certain lender from foreclosing on any of its loans that were deemed to be “presumptively unfair” or unsuitable without prior written approval from the Attorney General. The injunction was sought after the lender, which had previously entered into a consent agreement with the Federal Deposit Insurance Corporation (FDIC) over the lender’s allegedly unsound origination practices, and the Commonwealth had entered into an agreement whereby the lender and the Commonwealth consented to a notice and objection process for all foreclosures that the lender might seek to initiate.

The loans-in-question contained the following four characteristics: (1) an adjustable rate of three years or less; (2) an introductory/teaser rate for the initial period that is 3 percent lower than the fully indexed rate; (3) the borrower has a debt-to-income ratio that would have exceeded 50 percent if measured by the fully indexed rate (rather than the introductory/teaser rate) and (4) the loan-to-value ratio is 100 percent or the loan carries a substantial prepayment penalty or a prepayment penalty that extends beyond the introductory period.

In finding a cause of action to support its theory of “suitability,” the Supreme Judicial Court upheld the lower court’s use of § 93A of Massachusetts’ Deceptive and Unfair Trade Practices Act. The Supreme Judicial Court claimed that § 93A creates new substantive rights, and in particular cases, “makes conduct unlawful which was not unlawful under the common law or any prior statute.” Central to the court’s analysis was the fact that violations of the Massachusetts Predatory Home Loan Practices Act also constituted unfair trade practices in violation of § 93A.

Despite the aforementioned loan characteristics, however, both the lower court and the Supreme Judicial Court admitted that the loans-in-question were not, by definition, “high cost mortgage loans” prohibited by the Massachusetts Predatory Home Loan Practices Act. Consequently, the lender claimed that it could not be held liable because there was no state or federal law prohibiting the lender from originating loans with the features at issue. The Supreme Judicial Court disagreed stating that the conduct sought to be prohibited by the Massachusetts Predatory Home Loan Practices Act was similar to the lender’s practices in the current case whether explicitly covered by that act or not. The court stated that “when [the lender] chose to combine in a subprime loan the four characteristics . . . [the lender] knew or should have known that they would operate in concert essentially to guarantee that the borrower would be unable to pay and default would follow.”

The Supreme Judicial Court further noted that although these loans were not explicitly prohibited by the Massachusetts Predatory Home Loan Practices Act, that did not mean the loans were suitable. “That the Legislature chose in the act to focus specifically on home loan mortgages with different terms and features . . . is not dispositive; the question is whether the act may be read to establish a concept of fairness that may apply in similar contexts.” The Massachusetts Predatory Home Loan Practices Act, reasoned the court, was merely “an established, statutory expression of public policy that it is unfair for a lender to make a home mortgage loan secured by the borrower’s principal residence in circumstances where the lender does not reasonably believe that the borrower will be able to make the scheduled payments and avoid foreclosure.” As such, reasoned the court, similar conduct, whether explicitly covered or not, could constitute a violation of § 93A. In fact, noted the Supreme Judicial Court, the lender had cited no state or federal authority that permitted the combination of the aforementioned loan characteristics at the time the loans were originated. Consequently, the Supreme Judicial Court essentially found that it was the lender’s burden to establish that the loans were suitable rather than the Attorney General’s burden to establish that the lender had violated a specific law and, thus, originated an unsuitable loan.

Even assuming liability could stand for conduct that was not expressly prohibited by the Massachusetts Predatory Home Loan Practices Act (i.e., because that act only applied to high cost loans), the lender argued that imposing liability would be a retroactive application of the law at best. The lender argued that its conduct should be viewed under the mortgage industry standards at the time the loans were made, as opposed to current standards. Once again, the Supreme Judicial Court disagreed. The court held that originating loans with this combination of features was “within established concepts of unfairness at the time the loans were made and thus in violation of §93A.” The court further pointed to the lender’s consent agreement with the FDIC. While the court stated that the agreement contained no admission of wrongdoing and, thus, it would not consider the agreement as evidence of liability on the lender’s part, the court noted that the agreement indicated that the FDIC considered the lender’s conduct to violate established mortgage lending standards.

In light of the Massachusetts Supreme Judicial Court’s decision, the concept of suitability is alive and well. While the Supreme Judicial Court of Massachusetts did not create a common law tort for suitability or explicitly create a new cause of action, it clearly endorsed the theory in the form of a violation of the state’s Deceptive and Unfair Trade Practices Act (even though the actual conduct had not previously been adjudged to be illegal). Indeed, other lenders are already finding complaints on their doorsteps based on similar theories which advocate a retroactive application of the law, at best. Thus, the question becomes will other courts impose liability on these lenders, as well, by taking Massachusetts lead?

This decision indicates that “suitability” is not going away any time soon and in fact, may be here to stay. Consumer rights attorneys had already been citing the underlying case in briefs throughout the county in support of their issues. The current opinion will only give them more fuel to add to the fire as the decision marks a major victory for their clients. Once again, the more interesting question is how will other courts throughout the nation interpret the opinion? Will they use this case’s logic to create a suitability standard for their own states? Will they choose not to follow the case but only because of its unique set of facts? Will they flatly reject the case and its support of suitability? Time will tell.