

Preparing Effective Responses to Investigations in the Subprime Arena

May 3, 2007

New York Attorney General Andrew Cuomo announced his intention to investigate the practices of subprime lenders at a news conference on March 15. This intention turned to action in the last week when Mr. Cuomo's office sent subpoenas to more than thirty mortgage lenders and servicers that conduct business in New York. The subpoenas are understood to focus on appraisal practices and compensation for mortgage brokers.

In this note we set out the background to the current investigation, and provide suggested responses should your organization become drawn into the investigation.

Background

When New York Attorney General Andrew Cuomo announced his intention to investigate the practices of subprime lenders, he declined to provide details on the inquiry. However, the subpoenas that have been issued by his office are understood to focus on appraisal practices of, and compensation for, mortgage brokers. Mr. Cuomo (a former secretary of the Department of Housing and Urban Development) is said to be interested in the degree to which lenders bear responsibility for mortgage brokers who steer borrowers into more expensive loans.

The New York Attorney General's office has previously investigated the subprime lending market. In December 2006, Eliot L. Spitzer, the then attorney general, announced a settlement with Countrywide Financial, the biggest US mortgage lender, to compensate minority borrowers in New York who were charged more than white borrowers for loans. Earlier the same year, Spitzer and attorneys general in 48 states signed on to a \$325 million settlement agreement with Ameriquest Mortgage, the nation's largest subprime lender, in connection with Ameriquest's sales, appraisal, and closing practices.

Parallels in the Student Loan Industry

Following in Spitzer's footsteps, Cuomo recently targeted the student loan industry, claiming to have unearthed questionable links between student loan lenders, university officials, and a

government department. The focus of his investigation has been the "preferred lender" lists that financial aid officials compile to help students choose loan providers based on the lenders' merit. It has been claimed that some lenders have secured a place on the list through questionable practices.

More than 100 colleges and several lenders have received subpoenas or requests for information. A senior official from the Department of Education who oversaw the industry, and financial aid officers from a number of universities have been suspended pending the outcome of the probe. According to Mr. Cuomo's office, one university official was paid \$65,000 in "consulting fees" and tuition-fee reimbursements for that official's own studies, possibly in return for a place on the preferred lender list. The lender concerned has placed its chief executive and two other senior managers on leave. Additionally, in a recent settlement, another major student lender agreed to adopt a code of conduct drawn up by Mr. Cuomo's office and to pay \$2 million into a fund to educate students about loans.

Implications for Lenders and Servicers

The ongoing student loan investigation has demonstrated the potentially far-reaching consequences of this new initiative by the Attorney General's office. The increasing level of congressional interest in subprime lending will only serve to raise the stakes for lenders in this market.

Should your organization become the subject of an investigation, in-house counsel at mortgage lenders and servicers must take the following steps promptly:

- Learn the sources of potentially responsive information and ensure that this information—both paper copies and electronically stored information—is preserved.
- Develop a proactive strategy that deals with the possibility of multiple and simultaneous demands for information in an investigation that expands across jurisdictions.

- Engage in a dialogue with the enforcement agency conducting the investigation regarding the scope of information sought, the agency's priorities, and the timeframe for responding to requests for information.
- Take steps to understand the laws governing the scope of the investigation and potential remedies available to enforcement agencies.
- Take immediate steps to plan for the review and production of potentially responsive materials.

Working with experienced advisers at an early stage of an investigation can be critical in achieving effective results. For example, during the 2005 investigation by Eliot Spitzer, several of the national banks that received subpoenas requesting information based upon their HMDA data (including a break down of mortgage loan originations by race, gender and zip codes) declined to comply on advice from the OCC. The OCC sued Spitzer and won at the district court level.

Drawing in the Right Resources

At Mayer, Brown, Rowe & Maw LLP, we have been actively monitoring developments in the subprime market and the implications for our clients. Our financial services practice in Washington, DC, has been monitoring Congressional and Executive branch activity on subprime mortgage lending, while our securitization practice is advising the industry body, The American Securitization Forum, on a major portion of the industry's response to the current difficulties, including assignee liability issues. Our Congressional Oversight Strategy Group has been actively involved in many Congressional and Administration investigations, including student loans, the backdating of stock options and excessive professional fees.

As a firm, we also have extensive experience advising clients on responding to investigations from the New York Attorney General's Office. We are able to use this experience to determine the most effective strategy to guide our clients through any investigation.

Our experience in responding to the recent investigations into practices in the student lending industry, where we represented a major student lender, may be of particular value to mortgage lenders and servicers facing investigation. Through this work, our attorneys have:

- Managed and narrowed responses to information demands issued by the New York Attorney General, as well as other enforcement agencies;
- Advised clients on the likely concerns and expectations of enforcement agencies during the course of an investigation into lending practices, and developed a proactive strategy to respond effectively;
- Advised on the preservation of sources of potentially responsive information, including methods to efficiently identify, gather, and review for responsiveness electronically-stored information; and
- Managed numerous simultaneous investigations at the state and federal level, where these have expanded to jurisdictions beyond New York.

For More Information

If you would like more information on this issue, or to discuss an approach that your organization has received in relation to this investigation, please contact any of the following:

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