



# How <sup>the</sup> Recession <sup>Has</sup> Affected Banking <sup>and</sup> Law <sup>the</sup> Financial Industry

By Matthew D. Saltzman



**T**oday's economic crisis can be seen as a final chapter in the evolution of mortgage lending. Once upon a time, home mortgage loans were made by local community bankers, such as the one played by Jimmy Stewart in the movie *It's a Wonderful Life*. Over time, community banks ceded the residential loan business to lenders with larger marketing budgets and economies of scale, such as large national banks and specialized mortgage lending companies like Countrywide. Wall Street firms like Bear Stearns and Lehman Brothers joined government-sponsored agencies to package and securitize loans, acting as wholesale lenders to retail mortgage brokers.

Non-traditional mortgage products, such as sub-prime mortgages and loan payment alternatives that promoted easy access to home purchases, contributed to the creation of the real estate bubble and inevitably the "Great Recession." While not actively involved in making problem residential loans, Nevada community banks have been caught

up in a tsunami of bank failures and the collapse of real estate prices.

Community banks are smaller than mega banks and are typically chartered by state regulators rather than federal regulators. These smaller community banks focus on making loans to small and medium-sized businesses, including loans to develop smaller commercial centers, offices, and industrial buildings. Consumers, devastated by declines in their home values, dramatically reduced their spending, leading to business cutbacks, unemployment, and commercial real estate market turmoil. Community banks with large numbers of loans secured by commercial real estate collateral failed in significant numbers, and survivors are now struggling to raise additional capital.

## The new federal banking law

Seeking to prevent the reoccurrence of the cur-

rent financial crisis, Congress passed, and President Obama signed into law, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). At 2,300 pages, this sweeping legislation significantly impacts the banking industry by requiring various federal regulatory agencies to promulgate approximately 250 new rules and conduct over 65 "studies" that can result in additional rule making. While many of its provisions only affect banks with more than \$10 billion in assets, excluding most community banks, the Act still affects community banks in many ways.

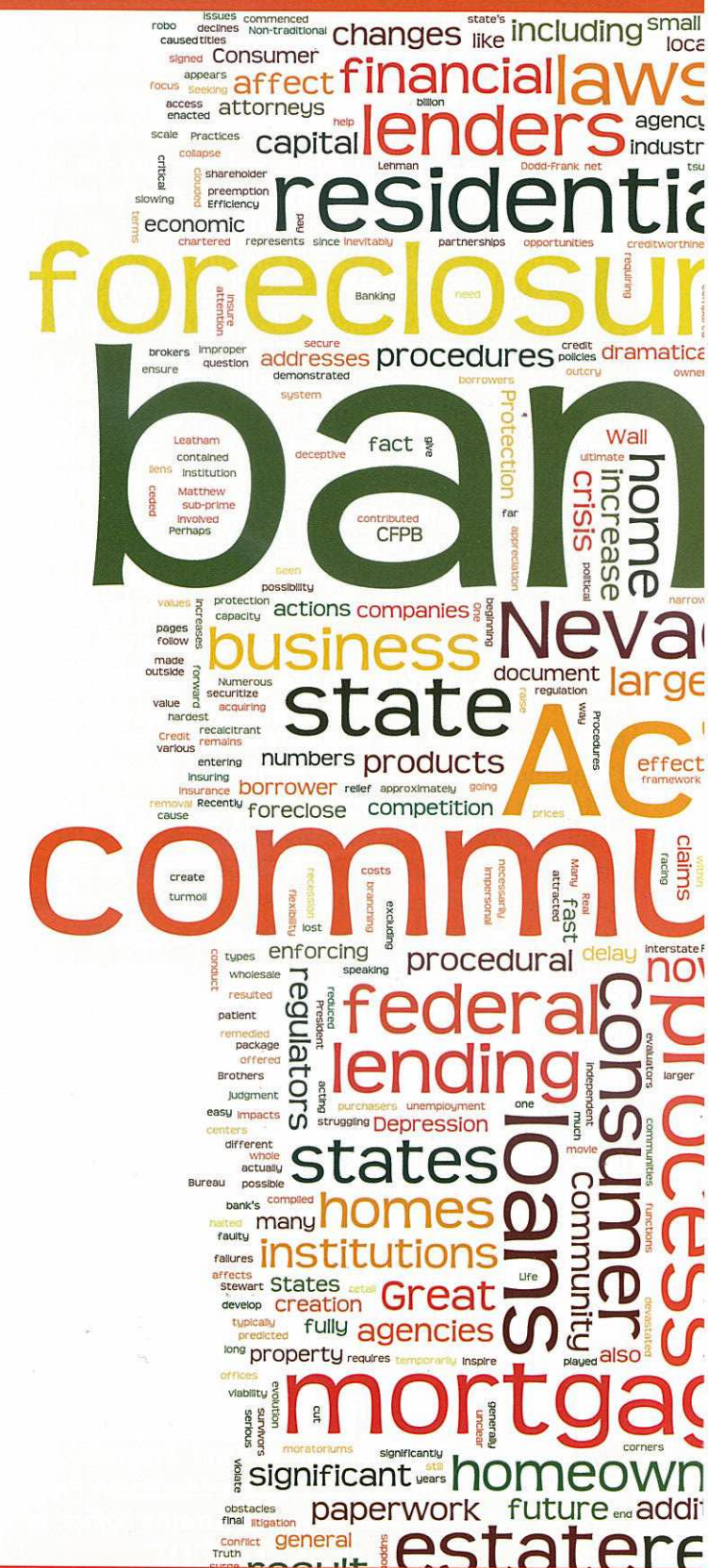
The most significant provision of the Act is the establishment of the Consumer Financial Protection Bureau (CFPB), a new independent executive agency within the Federal Reserve system. The CFPB will take over most of the consumer protection functions currently overseen by federal agencies enforcing the existing Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Debt Collection Practices Act, and Fair Credit Reporting Act.

The Act requires smaller community banks to follow new consumer lending rules that could affect the availability of consumer credit. Also as a result of the Act, banks will now be able to pay interest on business deposits. For community banks, this change could increase costs, further narrow net interest margins, and add an element of rate competition for commercial deposits.

Many community banks secure business loans with residential property. Any loan secured by liens on residential property may now be subject to the Act's new mortgage standards. These new rules, generally speaking, require the bank to ensure and document that the borrower has the capacity to repay the loan. It is unclear whether these new rules will have a chilling effect on the ability of the business borrower to pledge residential real estate as collateral for business loans.

One provision of the Act that has attracted little attention or political opposition, but which could have a significant impact on Nevada community banks, is the removal of the restrictions on interstate branching contained in the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act (Riegle-Neal). Under Riegle-Neal, banks have been limited in their ability to establish branches outside of their home states without acquiring a whole institution. The

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## Nevada Foreclosure Mediation Program: An Update to a Working Legal Remedy

By Michael Sommermeyer

The Nevada Foreclosure Mediation Program (the Program) was created by the 2009 Nevada Legislature to address the foreclosure crisis and provide a way to keep Nevada families in their homes.

The law, A.B. 149, specifically directs that the Program provide an opportunity for homeowners and lenders to discuss alternatives to foreclosure. The Program applies to residential properties located in Nevada that are owner-occupied and the primary home of owners. Funded by user fees from notices of default and mediation fees paid by the parties, the Program is financially self-sufficient.

A total of 8,738 homeowners elected to participate in mediation in the Program's first year from July 1, 2009 to June 30, 2010. The Program began mediating cases in September 2009 with mediators being assigned 6,164 mediations. A total of 4,212 mediations were completed by the Program. Of that total, 445 resulted in the issuance of a certificate allowing foreclosure. This represents 11 percent of the total number of mediations completed. A far larger number, 3,767, resulted in no foreclosure and no certificate issued by the Program, totaling 89 percent of all of the mediations completed. Of the mediated cases, 2,590 resulted in agreements with lenders, with 1,922 owners remaining in the home. This represents 46 percent of the 4,212 total mediations completed.

Nearly 300 attorneys, professional mediators, real estate professionals, and others have been appointed by the Nevada Supreme Court to serve as mediators for the program. Mediators receive extensive training and are required to remain neutral and serve as facilitators.

The Program anticipates a strong need for mediation during the next three years as part of Nevada's effort to bring stability to the state's housing market. Economists predict it will be the end of 2013 before Nevada sees substantial improvement in its economy, making the Program an important part of the state's initiative to help Nevadans avoid foreclosure. **G**

Michael Sommermeyer is Lead Program Analyst for the State of Nevada Foreclosure Mediation Program, Nevada Supreme Court - Administrative Office of the Courts.

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Act removes these restrictions, allowing national and state banks to establish branches in any state if a state-chartered bank would be permitted to establish the branch. This could create opportunities for Nevada community banks to expand into other states, but also increases competition from institutions entering Nevada.

The Act also addresses obstacles states encountered in enforcing unfair lending laws against national banks. Conflict developed between federal and state regulators as to whether the state had jurisdiction over the lending practices of national banks. In a victory for state attorneys general, the Act halted the expansion of federal preemption for national banks and federal thrifts, and enhanced the role of states in the regulation of consumer financial laws. States may now have greater flexibility to take more aggressive actions to enforce state consumer laws against federally-chartered banks.

Yet, little in the Act addresses community banks' critical need for capital and relief from certain accounting rules that further diminish a community bank's capital position. The future of community banks is uncertain, which should be of concern since community banks enjoy long partnerships with the communities they serve. Community banks want to support local businesses and homeowners with re-

sponsible loans and deposit products. In fact, community banks are considered much more effective evaluators of the creditworthiness of borrowers compared to impersonal mega banks that design broad lending policies and procedures far away from the locations where transactions actually take place.

### The future of foreclosures

Nevada had a non-judicial foreclosure process that, until recently, was quite streamlined and allowed for lenders to foreclose and obtain title to residential real estate collateral at a fast pace. This fast-paced process appears to be in the process of slowing.

Significant changes have occurred to Nevada's residential mortgage foreclosure process in light of the overwhelming increase in foreclosures. Nevada's (hitherto) fast and streamlined foreclosure process could be attributed to the fact that it was developed after the Great Depression, during years of relative prosperity and home value appreciation. Other states with large populations during the Great Depression enacted laws to give homeowners certain rights that often allowed them to delay foreclosures or avoid the imposition of a deficiency judgment based on procedural issues. During this current economic crisis, the outcry from homeowners in Nevada facing foreclosure resulted in legislation that affords additional rights to homeowners to engage in mediation in an attempt to inspire the mortgage lender to modify the terms of the mortgage rather than foreclose.

Recently, it has been reported that the overwhelming volume of foreclosure activity has caused some financial institutions to cut corners and improperly document foreclosure papers, resulting in procedural defects that could affect the validity of the title to the homes held by banks or third-party purchasers. Several banks recently implemented moratoriums on foreclosures while they figure out what went wrong and how to change procedures going forward. Litigation across the country has commenced against mortgage lenders for faulty and possibly fraudulent paperwork, including "robo signing" of documents, which some believe may violate Nevada's deceptive trade practices laws.

Numerous state attorneys general, including Nevada's, called on residential lenders to temporarily postpone foreclosures until it can be demonstrated that the lenders have fully complied with the state's laws. Assuming that foreclosure transactions have occurred with improper paperwork or procedures, it is possible that the titles to homes that have been conveyed through the foreclosure process to buyers may have a clouded title. This may increase litigation by homeowners who have lost their homes through the foreclosure process on procedural grounds.

Perhaps the hardest that would be hit by these claims are title insurance companies that insure the current owner's

title. These title insurers could be inundated with claims and may abstain from insuring title for homes conveyed through the foreclosure process. Another related possibility is that homes currently owned by banks as a result of foreclosure may be held off the market until paperwork deficiencies can be remedied. Such a delay, if widespread, could cause serious distortions in the residential real estate market.

We are past the beginning of the Great Recession's devastation of banks and financial institutions, but not necessarily close to the end. The ultimate effect of the recession and the changes in banking laws that it has spurred cannot be fully predicted. The creation of a large consumer regulatory agency could dramatically change the way consumer lending is conducted in the United States. It is likely that the foreclosure process in Nevada and other states will be materially different in the future as a result of the surge of foreclosure actions and problems with recalcitrant lenders. These changes to the legal framework of the banking industry will undoubtedly impact the viability of small community banks and the types of products and services offered. The question remains whether the medicine will help the patient or hurt it. **G**

Matthew D. Saltzman is a shareholder at Kolesar & Leatham, Chtd. He represents community banks and other financial institutions in Nevada.

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