



Guidance on Non-Traditional Mortgage Product Risks June 18, 2007

The Pennsylvania Department of Banking has recently issued guidance about sound business practices in non-traditional mortgage lending (the Guidance). Consistent with similar guidance issued by the federal banking agencies for depository institutions and the Conference of State Bank Supervisors for non-depository institutions, the Guidance provides a “best practices” approach to the assessment and management of the risks associated with non-traditional mortgage products. The Guidance focuses on “the higher risk elements” of certain non-traditional mortgage products and not the product itself. Providers with sound underwriting and adequate risk management will not be subject to criticism merely for offering such products.”

The Guidance advises lenders to: (1) ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower’s repayment capacity, (2) ensure that risk management practices correspond to the growth of non-traditional mortgage products and changes in the mortgage industry, and (3) ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product choice. The Guidance also recommends practices for addressing the risks raised by non-traditional mortgage products, including enhanced consumer disclosures and stronger compliance and control systems.

The Guidance is similar in nature and scope to the federal and state regulatory guidance noted

above. When read in conjunction with the Department’s Statement of Policy issued on January 12, 2007, however, as well as proposed regulations and various legislative reforms concerning the proper conduct of mortgage lending, the Pennsylvania mortgage industry should expect significantly enhanced regulatory oversight and scrutiny. On a more global level, the industry will be watching to see how enhanced state oversight of the mortgage industry will impact federal regulatory oversight efforts in this area, particularly by the OCC, following the preemption ruling by the U.S. Supreme Court in *Watters v. Wachovia*, Docket No. 05-1342 (April 17, 2007).

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