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2

Moving Sarbanes-Oxley to the Mortgage Industry

by [Lora Bentley](#), *IT Business Edge*
Jun 11, 2007 12:00:00 AM

Lora Bentley spoke with William McCloskey, commercial mortgage broker and Sarbanes-Oxley whistleblower. He has written for such publications as [Scotsman Guide](#), and [Mortgage Trap](#).

Bentley: You were able to establish a prima facie case under the whistleblower provisions of the Sarbanes-Oxley Act of 2002 even though your former employer was not a public company. Can you explain how the Department of Labor/court came to that conclusion?

McCloskey: Well, I am an avid reader of the Wall Street Journal, so I knew about the Act, and when I was fired from my former company, I knew that the Act was in place. Even though they weren't a publicly-traded company, I knew that they sold the bulk of their loans on the secondary market. These loans were pooled as asset-backed or mortgage-backed securities, so I basically made that argument to the administrative law judge.

Bentley: You are lobbying that Sarbanes-Oxley should be extended to apply to the mortgage industry. In what respects?

McCloskey: I certainly don't consider myself a lobbyist, but I do think it's important to get the information out there. I'm simply pointing out that the concept of suitability was transferred from the securities industry to the mortgage industry the very moment that Sarbox was signed into law in 2002. Here's the reason why: Companies that issue asset-backed securities have a reporting obligation under either section 13a or section 15d of the Securities and Exchange

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November 2010
October 2010
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August 2010
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Act of 1934 — at least for a period of time. All sub-prime loans are issued as asset-backed or mortgage-backed securities. If a mortgage company issues asset-backed securities on the open market and remains the master-servicer of the loan pool, the company's reporting obligation under sections 13a or 15d of the Securities and Exchange Act of 1934 is not suspended — it continues. This automatically holds subprime lenders accountable to Sarbox. This means that the originator of subprime loans is one of the key players for the ultimate sale of the security.

Bentley: Can you elaborate on the concept of "suitability?"

McCloskey: Suitability means determining whether loans would be suitable for a customer. When a stockbroker pitches a security, a stockbroker has to ascertain whether the stock is appropriate for that particular customer. The same now applies to loan originators, specifically subprime originators, because again, they're pooled on the secondary market. The subprime lenders do not service the loans for the life of the loans.

This could not only prevent lenders from placing people, say, within the Alt-A range if it was a subprime loan, it can prevent mortgage brokers from charging a warehousing fee because — obviously — a mortgage broker is not the lender.

Bentley: Would this be something that industry groups would enforce on their own, or should it be legislated by Congress first?

McCloskey: I don't think the industry groups would ever enforce this on their own. For instance, I gave testimony before the Pennsylvania House Commerce Committee on May 11, and I did not get many questions after I gave my statement. I've also contacted Congressman Barney Frank's office several times, and I've not heard from them. I think it's a shame that a law is already on the books that could force mortgage executives to retrain their loan officers to pitch programs that are better suited to their customers, and it isn't well known. I think Congress ultimately would have to enforce its own law. They're coming up with all these cockamamie schemes to reduce the availability of these loans to people with bad credit...and they don't realize that a law on the books could solve the problem.

Bentley: If the change is made, how would it affect a mortgage company's compliance responsibilities?

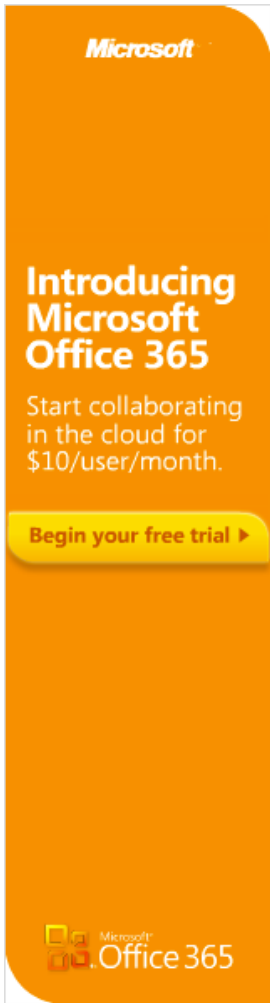
McCloskey: If the industry comes to the conclusion that Sarbanes-Oxley applies, it would mean that all direct lenders of subprime loans would be accountable for section 404 of Sarbox. In other words, they will have to establish, document and maintain internal controls for financial reporting just like a publicly-traded company.

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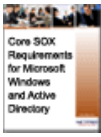
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