

# HOUSE BILL REPORT

## HB 3319

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### As Reported by House Committee On:

Insurance, Financial Services & Consumer Protection

**Title:** An act relating to residential mortgage loans.

**Brief Description:** Addressing residential mortgage loans.

**Sponsors:** Representative Kirby.

### Brief History:

#### Committee Activity:

Insurance, Financial Services & Consumer Protection: 2/5/08 [DPS].

#### Brief Summary of Substitute Bill

- Requires a mortgage broker to act in the utmost good faith toward a borrower. A mortgage broker is prohibited from receiving undisclosed compensation.
- Requires lenders making a residential mortgage loan must use sound underwriting principles.
- Limits prepayment penalties to 60 days prior to the initial reset period of an adjustable rate mortgage. In no case may a penalty exceed three years after the date of the closing of the loan.

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### HOUSE COMMITTEE ON INSURANCE, FINANCIAL SERVICES & CONSUMER PROTECTION

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 6 members: Representatives Kirby, Chair; Kelley, Vice Chair; Hurst, Loomis, Santos and Simpson.

**Minority Report:** Do not pass. Signed by 3 members: Representatives Roach, Ranking Minority Member; Rodne and Smith.

**Staff:** Jon Hedegard (786-7127).

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

## **Background:**

### Regulation of Financial Institutions

Financial institutions are regulated in accordance with their charters. A financial institution may be chartered in Washington, a different state, or the federal government. An institution that is chartered in Washington is subject to the regulatory authority of the Department of Financial Institutions (DFI).

### Mortgage Broker Licensing

The DFI licenses mortgage brokers and loan originators under the Mortgage Broker Practices Act (MBPA). The MBPA has provisions regarding licensing, continuing education, prohibited practices, examinations, investigations, and criminal, civil, and administrative penalties.

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## **Summary of Substitute Bill:**

The bill provides a number of definitions.

### Mortgage Broker's Duty to a Borrower

A mortgage broker and any person working with or for a mortgage broker must:

- act in the utmost good faith toward the borrower; and
- not compromise a borrower's right or interest.

A mortgage broker, designated broker, loan originator, and other persons working with or for mortgage brokers must not receive any undisclosed compensation.

### Sound Underwriting

Financial institutions must use sound underwriting principles. The DFI must adopt rules to develop rules for sound underwriting principles.

### Limitations on Prepayment Penalties

A financial institution may not make or facilitate the origination of a residential mortgage loan that includes a prepayment penalty or fee that extends beyond:

- 60 days prior to the initial reset period of an adjustable rate mortgage; or
- three years after the date of the closing of the loan.

## **Substitute Bill Compared to Original Bill:**

The provisions concerning the duties of a mortgage broker are modified. Specific requirements regarding sound underwriting are struck. The permissible time-frame for a prepayment penalty is reduced from five years to three years. The section requiring a comparison chart when refinancing a loan is removed.

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**Appropriation:** None.

**Fiscal Note:** Requested on February 1, 2008.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony:**

(In support) There is a Governor-request bill on these topics. This bill is intended to be a forum for a discussion of the substantive issues that are not agreed to by all of the stakeholders. Some of these provisions are already a compromise for the consumer advocates. There are some additional amendments that may resolve some of the issues for the lenders and mortgage brokers. The discussion of these issues is not over. There may be additional modifications as the dialogue continues.

This bill creates additional safeguards. There are over 30 states that have some of these protections. The bill codifies practices that have existed for quite some time. Mortgage brokers make over 70 percent of the subprime loans. Mortgage brokers are not required to act in a borrower's best interest. Most mortgage brokers do act in the interest of their borrower but others do not. There are financial incentives to act contrary to the best interest of the borrower. If the borrower pays more for the loan, the mortgage broker may make more money. The bill imposes basic standards that are necessary for the role that a mortgage broker purports to play. Mortgage brokers want the title and standing as financial professionals, but financial professionals have fiduciary duties to their clients. The committee may want to review a Senate bill that provides more language around the duty of a broker. The comparison for refinanced loans makes sense. Current law requires certain disclosure but it is not always meaningful information. If a borrower doesn't have the information, he or she can't make an informed decision. A transaction like that is inherently unfair. The bill appropriately focuses more on civil remedies than criminal penalties. Courts have held that mortgage brokers don't have a duty to a borrower because the Legislature has never imposed a duty.

(Opposed) Many of the concepts in this bill were considered but not recommended by the Governor's task force. Some of the provisions place restrictions on state-chartered institutions that are not placed on federally-chartered institutions. There is a proposed amendment to strike the section requiring a comparison of an existing loan and a proposed refinanced loan. The section would be difficult to implement. The provision limiting prepayment penalties to five years is not troublesome but reducing it to three years is an issue. Most of the industry is moving to a three-year standard but to require that standard will limit product options for consumers. Financial institutions use sound underwriting today. To create a standard applicable solely to Washington-chartered institutions puts those local businesses at a disadvantage. The comparison for refinanced loans is unnecessary and difficult. The duties placed on mortgage brokers are a concern. There is no definition of sound underwriting. The comparison chart is a problem. The requirement that all borrowers have taxes and insurance escrowed is a problem. Some sophisticated borrowers may have their hands tied by that provision. It should be an option, not a requirement. The duties placed on mortgage brokers extend to their employees. This is a concern for captive agents. It should be limited to third-party brokers. The escrow provision is going to be an issue for some borrowers.

**Persons Testifying:** (In support) Representative Kirby, prime sponsor; Kim Justice, Statewide Poverty Action Network; and Melissa Huelsman.

(Opposed) Denny Eliason, Washington Bankers Association; Brad Tower, Community Banks of Washington; Steve Buckner, Washington Association of Mortgage Brokers; Mark Minickiello, Washington Credit Union League; and Scott Hazlegrove, Washington State Financial Services Association.

**Persons Signed In To Testify But Not Testifying:** None.