HOUSE BILL REPORT
SB 6728

As Reported by House Committee On:
Insurance, Financial Services & Consumer Protection

Title: An act relating to homeownership security, responsible mortgage lending, and improving protections for residential mortgage loan consumers.

Brief Description: Enacting the governor's homeownership security task force recommendations regarding responsible mortgage lending and homeownership.

Sponsors: Senators Berkey, Kohl-Welles, Franklin, Regala and Keiser.

Brief History:
Committee Activity:
Insurance, Financial Services & Consumer Protection: 2/21/08 [DP].

Brief Summary of Bill

- Requires additional disclosure to mortgage borrowers.
- Prohibits prepayment penalties that extend beyond 60 days prior to the initial reset of an adjustable rate mortgage in residential loans.
- Prohibits negative amortization for a borrower in residential loans.
- Prohibits the steering of consumers into higher cost loans.
- Establishes the framework and penalties for crimes related to mortgage fraud.

HOUSE COMMITTEE ON INSURANCE, FINANCIAL SERVICES & CONSUMER PROTECTION

Majority Report: Do pass. Signed by 9 members: Representatives Kirby, Chair; Kelley, Vice Chair; Roach, Ranking Minority Member; Hurst, Loomis, Rodne, Santos, Simpson and Smith.

Staff: Jon Hedegard (786-7127).

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:

<u>Regulation of Financial Institutions</u>
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).

<u>State and Federal Issuances on Mortgage Lending</u>
In October 2006 federal financial regulators published the final *Guidance on Nontraditional Mortgage Product Risks (Guidance)*. "Nontraditional" mortgage products include interest-only mortgages, payment option adjustable rate mortgages, and other products that have negative amortization (certain products that result in monthly payments where the payment is insufficient to cover the interest due on the loan). The national associations for state financial regulators adopted parallel standards to address state-licensed mortgage entities that are not subject to the federal guidance.

In June 2007 federal financial regulators published the final *Statement on Subprime Mortgage Lending (Statement)*. The *Statement* addresses the use of hybrid adjustable rate 30-year mortgages that have low rates for a two- or three-year period before adjusting for a 27- or 28-year period. The national associations for state financial regulators adopted parallel standards to address state-licensed mortgage entities that are not subject to the federal statement.

<u>Mortgage Broker Licensing</u>
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.

<u>Foreclosure on Mortgages and Deeds of Trust</u>
Mortgages and deeds of trust are two forms of security interest in real property used for real estate financing. A mortgage is a pledge of real property as security for a debt owed to the debtor. A mortgage creates a lien on the real property. A mortgage may be foreclosed only through a judicial proceeding according to detailed statutory requirements and procedures.

A deed of trust is, in essence, a three-party mortgage. The borrower grants a deed creating a lien on the real property to a third-party (the trustee) who holds the deed in trust as security for an obligation due to the lender. The deed of trust transfers title to the borrower, yet the trustee has a lien against the property until the borrower pays off the obligation in full. If the borrower defaults on the obligation, a deed of trust may be foreclosed without a judicial proceeding. The trustee may foreclose on the property by conducting a public trustee sale when the required procedural and notice requirements are met. The trustee must provide notice to the borrower 30 days prior to the recording of a notice of sale. At least 90 days prior to a sale, the trustee must record a notice of sale in the office of the auditor in the county where the property is located.

Criminal Profiteering
In 1985 the Legislature passed laws regarding "criminal profiteering." These laws are similar to the federal Racketeering Influenced and Corrupt Organizations (RICO) Act. Criminal profiteering involves the commission of a crime listed in the statute for financial gain. Crimes that are included in the statute are: violent felonies and felonies associated with gambling, drugs, pornography, prostitution, extortion, identity theft, insurance fraud, and securities fraud. There are criminal penalties and civil remedies for criminal profiteering. The civil remedies include monetary penalties, injunctive remedies, and forfeiture.

In September 2007 Governor Gregoire established the Task Force for Homeowner Security (Task Force) to evaluate instability in the mortgage market and minimize the impact in Washington. The Task Force met six times between September and mid-December and issued a report on December 21, 2007. The report included approximately 24 recommendations, including:
- improving disclosure;
- notice to homeowners facing potential foreclosure;
- adoption of the federal guidance and statement by rule by the DFI;
- prohibiting the steering of consumers into higher cost loans;
- limiting prepayment penalties;
- prohibiting certain products that result in negative amortization;
- clarifying the duty a mortgage broker owes to a customer; and
- increasing the penalties for mortgage fraud.

Summary of Bill:

A number of definitions are provided. "Financial institution" is defined to include: state chartered banks, consumer loan companies, credit unions, mutual savings banks, savings and loans, and mortgage brokers.

Disclosure
The DFI must adopt a disclosure summary understandable to the average person that includes:
- the fees and discount points on the loan;
- the interest rate of the loan;
- the broker's yield spread premium;
- the presence of any prepayment penalties;
- the presence of a balloon payment;
- whether or not property taxes and property insurance is escrowed; and
- other key terms and conditions of the loan.

A residential mortgage loan may not be made unless the summary is provided by a financial institution to a borrower within three days of a loan application. If the terms of the loan change, a new summary must be provided to the borrower within three days of the change or at least three days before closing, whichever is earlier.

State and Federal Issuances on Mortgage Lending

The DFI must adopt rules and apply the *Guidance* and *Statement* to financial institutions. The financial institutions must adopt and adhere to policies that are reasonably intended to achieve the objectives in the *Guidance* and *Statement*.

Prepayment Penalties
A financial institution may not make or facilitate the origination of a residential mortgage loan that includes a prepayment penalty that extends beyond 60 days prior to the initial reset of an adjustable rate mortgage.

Negative Amortization
A financial institution may not make or facilitate the origination of a residential mortgage loan that is subject to the *Guidance* and *Statement* if the loan includes any provisions that result in negative amortization for a borrower.

Steering
A person subject to licensing under the MBPA or the Consumer Loan Act may not steer, counsel, or direct any potential borrower to accept a residential mortgage loan with a risk grade less favorable than what the borrower would qualify under the lender's existing underwriting standards. The licensee must prudently apply the underwriting standards to the information provided by the borrower.

Rules
The DFI is given general authority to adopt rules.

Mortgage Fraud
In the lending process, it is a class B felony to:
- defraud or mislead any borrower, lender, or person;
- engage in deceptive practices;
- obtain any property by fraud or misrepresentation;
- knowingly make, use, or facilitate a misstatement, misrepresentation, or omission knowing that it may be relied on by another; and
- receive anything of value in connection with a closing that resulted from a fraudulent practice.

A knowing violation or knowingly aiding or abetting a violation is "ranked" on the sentencing grid in the III tier. This places it on a level that gets a sentence ranging from one to three months up to five years in prison.

Mortgage fraud is added to the list of felonies that are subject to the criminal profiteering laws.

Any person who knowingly alters, destroys, or conceals information to impair the investigation of mortgage fraud is guilty of a class B felony.

Examinations, Investigations, and Enforcement
The DFI has the authority to investigate or examine mortgage brokers, state-chartered banks, state-licensed consumer loan companies, state-chartered credit unions, state-chartered mutual

savings banks, and state-chartered savings and loans to enforce applicable provisions of the MBPA.

Duties of Mortgage Brokers
Mortgage brokers, loan originators, and people working with or for mortgage brokers must:
- be actuated by good faith;
- abstain from deception; and
- practice honesty and equity in all matters related to their profession.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) The documents for a loan are 20 times the size that they were just 25 years ago. The act of buying a home is more complex today. People go to mortgage brokers because they need professional advice. Mortgage brokers don't have a fiduciary duty to borrowers in this state but they do have that duty in other states. The Task Force recommended prohibiting steering and providing additional disclosure. This is a good bill. Adding a fiduciary duty for mortgage brokers would make it better. The Task Force did not specifically discuss this subject. People have been hit hard by the foreclosure crisis. In a single month last year, 28 people living in my zip code lost their homes. Action and reform are needed. This bill will help people. There was a realtor representative on the Task Force. The bill represents the Task Force recommendations. The bill is based on recommendations that were adopted by the entire Task Force. The bill was a collaborative effort by the members of the Task Force. It reflects a unanimity of opinion. The bill implements a majority of the consensus recommendations of the Task Force. These are commonsense and necessary changes. There is a single word difference between SHB 2770 and this bill. The House version includes a correction.

(Opposed) None.

Persons Testifying: Fred Corbit, Northwest Justice Project; John Jones, Association of Community Organizations for Reform Now; Deborah Bortner, Department of Financial Institutions; Bob Mitchell, Washington Realtors; Denny Eliason, Washington Bankers Association; Adam Stein, Steve Buckner, and David Erickson, Washington Association of Mortgage Brokers; and Kari Burrell, Governor's Policy Office.

Persons Signed In To Testify But Not Testifying: None.