



# MEMORANDUM

September 18, 2008

To: Mortgage Lending Work Group

From: Cory Streisinger  
David Tatman

Subject: DCBS Tentative Recommendations

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A year ago, in September 2007, the Governor asked the Department of Consumer and Business Services to convene this work group to consider how we can best maintain a strong mortgage lending industry, in which mortgages are designed for success, and borrowers can choose mortgages that suit their needs. Thank you for the many hours you have spent working with us over the past months to address these issues. The work group proposals addressing foreclosure notices, “mortgage rescue” schemes, and stronger enforcement were enacted into law in February of this year. Following the February legislative session, we reconvened the group to begin discussions of various proposals regarding mortgage lending practices.

The mortgage market has changed considerably since this group was convened, and the changes continue. In just the past few months we have seen the adoption of strong new rules by the Federal Reserve, applicable to all mortgage lenders; enactment of new federal legislation addressing many aspects of mortgage lending; and the federal takeover of Fannie Mae and Freddie Mac, bringing the potential for changed underwriting standards for much of the market. Additional rulemaking and guidance at the federal level is also expected in the months to come.

These federal actions address many of the concerns raised during our discussions of mortgage lending, including enhanced disclosures for mortgages generally; disclosure of the maximum payment based on the maximum interest rate for adjustable-rate mortgages; restrictions on misleading advertising; prohibitions on coercion of appraisers to misrepresent value; and restrictions on loan servicing abuses. For “higher-priced” mortgages (essentially, subprime mortgages), additional protections include limits on prepayment penalties; a prohibition on making such loans without evaluating the borrower’s ability to repay; and a requirement to verify income and assets on which the lender relies. While there are still gaps in these federal actions which may best be filled by state regulation, we believe these changes represent substantial new protections for Oregon homeowners, and will require significant changes in business practices for many Oregon lenders.

We understand that many in the lending industry believe that the federal actions go far enough, and that lenders cannot absorb any additional state-level changes at this point, while many consumer representatives believe that some additional state-level protections are both appropriate and necessary. Since complete consensus is therefore unlikely, we agreed at our last work group meeting to set out DCBS' tentative proposals. We welcome your comments, and look forward to discussing these at our meeting on September 19.

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Enforcement of new federal standards. In order for the new federal standards to be effective, they must be enforced. We believe enforcement at the state level is critical, and we expect to propose legislation giving DCBS explicit authority to address violations of the Truth in Lending Act, including the rules recently adopted by the Federal Reserve; the Real Estate Settlement Procedures Act and its regulations; portions of the Equal Credit Opportunity Act and its regulations applicable to the appraisal process; and portions of the newly enacted Housing and Economic Recovery Act of 2008, P.L. 110-289. We note that the S.A.F.E. Mortgage Licensing Act of 2008, Title V of P.L. 110-289, grants states certain enforcement authority and requires that states be authorized to take action against state-licensed loan originators (see below) based on violation of state or federal law.

We believe the examination process provides an important tool for obtaining compliance with applicable standards, and we anticipate requesting additional mortgage lending examiner staff through the budget process.

Licensure of loan originators. The federal S.A.F.E. Mortgage Licensing Act of 2008 will require licensure of mortgage loan originators through a national system. Loan originators employed by depository institutions (banks and credit unions) will be registered at the federal level, but states are expected to license those loan originators employed by mortgage brokers/bankers and consumer finance lenders, and HUD will do so if states do not. We expect to propose legislation implementing this loan originator licensing requirement, consistent with the standards set out in the federal act including the overall objectives of uniformity and consumer protection.

Increased surety bonds. The S.A.F.E. Mortgage Licensing Act of 2008 will require us to establish minimum net worth or surety bond requirements reflecting the dollar amount of loans originated. We expect to propose an increased surety bond requirement for those licensed entities employing state-licensed loan originators, which will be tiered or scaled based on the dollar amounts of loans originated.

Good faith and fair dealing. We believe that all parties to a mortgage transaction should be subject to a general obligation of good faith and fair dealing, as a more workable concept than a fiduciary relationship. However, based on discussions at the work group, we believe an obligation of good faith and fair dealing may already exist as a matter of common law. All contracts in Oregon include an implied obligation of good faith and fair dealing, and some of the

industry representatives have asserted that a contractual relationship exists (although a loan contract does not) no later than the time of loan application. We also note that current Oregon law makes it unlawful for a mortgage broker/banker or loan originator to “engage in unfair or unethical practices or conduct in connection with the mortgage business,” ORS 59.971, which appears to cover much of the same ground and could be clarified through rulemaking. We would appreciate views from the work group on whether legislative clarification is needed regarding the existence of a contractual relationship for loan origination services, and to prohibit the obligation of good faith and fair dealing from being waived or disclaimed, or whether rulemaking might be appropriate.

Refinance loans; side-by-side comparison of loans and identification of net benefit. The work group has spent many hours discussing this concept, and we believe borrowers would be benefited by a side-by-side loan comparison, and an identification of the benefit of the refinance, prior to making a decision to refinance a loan. However, we are inclined to agree with those who advise against moving forward with this concept at this time. We note that the S.A.F.E. Mortgage Licensing Act of 2008 requires the Secretary of Housing and Urban Development to make legislative recommendations within six months regarding “more transparent disclosures, allowing consumers to better shop and compare mortgage loan terms and settlement costs,” and we think this is a reasonable period to wait before evaluating whether to move forward at the state level.

In addition, existing Oregon law applicable to mortgage brokers and mortgage bankers generally prohibits, in the course of a loan transaction, the omission of a “material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.” ORS 59.925(2)(b); 59.930(2). It is the view of the Department that the recommendation of a refinance loan or the description of such a loan as beneficial to the borrower, while omitting to accurately compare the terms of the refinance loan with those of the existing loan, would violate these provisions and constitute an unfair or unethical practice prohibited by ORS 59.971. We invite the views of the work group regarding whether these points should be clarified through rulemaking.

Negative amortization loans. We believe the Federal Reserve rules correctly identified the category of “higher-priced mortgages” as ones posing particular risks to borrowers. Protections for these borrowers include limits on prepayment penalties; a prohibition on making such loans without evaluating the borrower’s ability to repay; and a requirement to verify income and assets on which the lender relies. In addition to the category of “higher-priced mortgages,” however, we also see substantial risks to borrowers associated with mortgages containing a negative-amortization feature, or a “payment option” feature which permits a period of negative amortization. Due to the complexity of these loans, and the significant potential for abuse, we expect to propose legislation limiting prepayment penalties for these loans, prohibiting such loans without evaluating the borrower’s ability to repay, and requiring the verification of income and assets to the same extent as with “higher-priced mortgages” under the federal rules.

Availability of 30-year fixed loan; availability of prime-rate loan; steering. The work group has discussed the possibility of requiring that a borrower be offered a 30-year fixed-rate mortgage if one is available, or of requiring that a borrower who qualifies for a prime-rate loan be advised of that fact prior to being offered a sub-prime loan. Again, we note that existing Oregon law generally prohibits the omission of a “material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading,” and also prohibits unfair or unethical practices or conduct. While we do not intend to propose legislation addressing these issues, it is the view of the Department that the recommendation of a loan or the description of a loan as beneficial to the borrower, while omitting to disclose to the borrower options that would be more beneficial or suitable to the borrower’s circumstances, would violate these provisions. Again, we invite the views of the work group regarding whether this point should be clarified through rulemaking.

Fees, costs, yield-spread premiums. The Federal Reserve has not moved forward with rules on disclosure of yield-spread premiums, based on its consumer testing, but it has stated its intent to continue analysis of alternative approaches to this issue. Under the circumstances, we do not intend to propose legislation addressing yield-spread premiums or other disclosures of costs beyond those required by federal statutes and rules. As noted previously, however, existing Oregon law already prohibits material misstatements and omissions by mortgage brokers and bankers.

Disclosures in language other than English. For many Oregonians, taking out a mortgage can be the most significant financial transaction they will undertake, and understanding the transaction can be challenging for anyone. This challenge is significantly greater for those who do not speak English. When a lender chooses to advertise or solicit mortgage customers in a language other than English, and when significant communications concerning the loan take place in a language other than English, we believe it is appropriate for basic disclosures to be provided in the language in which the communications are made. We expect to propose legislation requiring that under these circumstances, the borrower be provided with translated versions of the federally-required Good Faith Estimate and Truth in Lending Act disclosures, at the same times those disclosures are given in English. DCBS will provide translations of the required forms in the three most commonly-used languages other than English (currently Spanish, Russian and Vietnamese).

Private right of action and attorney fees. Oregon law already contains a private right of action for violations of mortgage lending laws by mortgage bankers or mortgage brokers, ORS 59.925. Attorney fees may be awarded to a “prevailing party” under this section. In order to make this remedy meaningful and fair for homeowners, we do not believe an award of attorney fees would be appropriate against a homeowner bringing an action relating to a mortgage on his or her home, unless the plaintiff has brought the action in bad faith or solely for purposes of harassment. This is the standard adopted by the February 2008 legislature in HB 3130, for actions by equity sellers. We expect to propose legislation incorporating this standard into the attorney fee provisions in ORS 59.925.

Consumer financial education. For anyone entering into a complex financial transaction such as a mortgage, an understanding of key financial principles relating to credit and money management is key. While we have not formulated our own recommendations in this area, we look forward to working with the Credit Union Association of Oregon and others to hold a Financial Education Summit later this fall with the goal of establishing priorities for the future. We also look forward to hearing the report and recommendations of the Financial Education and Civics Task Force, established by the 2007 legislature.

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We understand there are likely to be widely divergent views on many of these issues, and ultimately the legislature will make the decision on many of them. Again, we look forward to hearing your thoughts on these issues before we formulate our final recommendations.