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REGULATE MORTGAGE COMPANIES

House Bills 4701-4703 as enrolled
Second Analysis (11-16-87)

Sponsor: Rep. John Bennett
House Committee: Corporations and Finance
Senate Committee: Commerce & Technology

THE APPARENT PROBLEM:

In recent years, a number of companies doing business in mortgages in Michigan are reported to have engaged in unscrupulous practices. The most recent, and perhaps the most notorious example is that of Diamond Mortgage and A.J. Obie and Associates, two firms under the same ownership, with the first making mortgage loans and selling those loans to investors brought in by A.J. Obie. As the firms began to collapse late last year, it became widely apparent that often a single mortgage had been sold to more than one investor and that although Diamond had been receiving investors' funds, it was not disbursing that money to borrowers. Losses to investors total roughly $50 million; borrowers lost an incalculable sum in the form of clouded titles and exorbitant fees. Both firms are in Chapter 7 (liquidation) bankruptcy, and the principals recently pleaded "no contest" to criminal charges of securities fraud.

The Diamond Mortgage scandal has highlighted a need for comprehensive state oversight of first mortgage transactions. Depository institutions, secondary mortgage lenders, real estate brokers, and securities broker-dealers all are regulated by state law, but state officials note that there is no single locus of responsibility for overseeing those in the business of making, brokering, or servicing first mortgage loans. Legislation has been proposed to ensure that adequate authority to monitor and regulate first mortgage lending is vested in a single agency.

THE CONTENT OF THE BILLS:

House Bill 4701

House Bill 4701 would create the Mortgage Brokers, Lenders, and Servicers Licensing Act, to regulate those who broker, make, or service first mortgage loans or land contracts on Michigan property designed for occupancy by four or fewer families. The bill generally would not apply to: lenders or servicers making or servicing ten or fewer mortgage loans annually; brokers, lenders, and servicers who were subsidiaries or affiliates of depository institutions or their holding companies; banks, savings and loans, and credit unions; residential builders and their agents; real estate brokers and salespeople who met certain criteria for exemption; secondary mortgage act licensees; home improvement contractors; federal, state, and local agencies, including the public employees retirement system; attorneys not in the business of making mortgage loans; fiduciaries of employee pension plans; and employers lending to employees to assist in meeting housing needs.

Failure to comply with the bill would not affect the validity or enforceablity of any mortgage loan, unless the mortgage was invalid or unenforceable under another law.

Generally, a person could not act as a mortgage broker, lender, or servicer without first obtaining a license from or registering with the state banking commissioner. Employees would be exempted from the licensure/registration requirement. Someone in the business at the time the bill took effect would have 90 days in which to comply with license application or registration requirements, and could continue to conduct business in compliance with the bill until the commissioner acted on the application. All fees received under the act would go into a special fund for the operation of the Financial Institutions Bureau.

Licensing

License requirements would apply to those not eligible for registration. Applications would have to be accompanied by proof of financial responsibility ($25,000 for someone who acted solely as a mortgage broker or a lender, $100,000 for a mortgage servicer) in one of the following forms: a corporate surety bond or irrevocable letter of credit approved by the commissioner; an obligation of the United States, any state, or any political subdivision with a maturity date of three years or less; a certificate of deposit with a federally insured financial institution with a maturity date of three years or less; or a true copy of the corporate surety bond the applicant was required to maintain on behalf of the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), or the Government National Mortgage Association (GNMA). The commissioner could waive or modify the financial responsibility requirements for a mortgage servicer who serviced no more than 300 loans and did not collect money for the payment of taxes and insurance on those mortgages.

Each licensee acting solely as a broker or lender would have to have a net worth in an amount, up to $25,000, determined by the commissioner. A mortgage servicer would have to have a net worth of $100,000.

Requirements for proof of financial responsibility and net worth that applied to people who acted solely as brokers would apply to those brokers who received funds from prospective borrowers prior to the closing of the mortgage.

An applicant would pay an investigation fee of $200 and and annual license fee of $300. Renewals would cost $300.

If, after investigation, the commissioner determined that the applicant was fit and that none of the grounds for revoking, suspending, or denying a license existed, the commissioner would issue a license.

Licensees would have to make annual reports as prescribed by the commissioner and the bill. Making a fraudulent report would be a felony punishable by a maximum prison term of 15 years.

A license could not be transferred or assigned without the consent of the commissioner. The transfer of more than 25 percent of the voting stock of a corporation or 25 percent of the interest in a licensee that was unincorporated would constitute transfer of the license.

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Registration
Generally speaking, those who are licensed or approved under related acts would register, rather than be licensed, under the bill. Registrants would not have to comply with requirements for proof of financial responsibility, net worth, and annual financial statements and commissioner examinations. Registration would apply to brokers, lenders, and servicers approved by the FNMA, FHLMC, or GNMA or licensed under the Regulatory Loan Act. Registration also would apply to real estate brokers and salespeople under certain circumstances. A subsidiary or affiliate of a depository institution could register under the bill and thus become subject to the provisions applicable to registrants; it would not, however, be subject to criminal penalties for transferring a mortgage prior to disbursing at least 75 percent of the proceeds to the borrower, nor for failing to meet certain requirements for effecting transfers through brokers or to investors who met certain criteria. The annual registration fee would be $300. A registration could not be assigned.

Recordkeeping
Licensees and registrants would have to maintain records as prescribed by the bill and the commissioner. If records were not available in Michigan, a licensee or registrant would have to pay an examiner's travel costs. Mortgage loan documents, transfer documents, and account records would have to be kept for three years.

Fees, Borrower Statements
In addition to interest, a licensee or registrant could charge reasonable and necessary fees for the actual costs of: recording; title examination or insurance; preparation of a deed, appraisal, or credit report; and a loan processing fee. The bill specifically would not override federal preemption of state usury laws.

A mortgage servicer would have to provide borrowers with annual account statements, and would have to provide a ledger history for the preceding 12 months within 25 days after receiving a request from the borrower. The servicer could not charge a fee for the statement or ledger history, but would not have to provide more than one of each per year.

Unlawful Acts
It would be a violation of the bill to: commit fraud; fail to disclose to borrowers information required by state or federal law; violate Public Act 125 of 1966, the law regulating mortgage escrow accounts; refuse to allow commissioner examinations or furnish required information; fail to pay fees; fail to make restitution when ordered to do so by the commissioner, an administrative agency, or a court; or fail to meet commitments made in connection with a mortgage loan when the other party had met his or her commitments.

Commissioner Authority, Remedies
The banking commissioner would exercise general supervision and control over mortgage brokers, lenders, and servicers doing business in Michigan. The commissioner could promulgate rules; conduct examinations and investigations as necessary; inform the attorney general and local prosecutors when a person was believed to be violating the bill (and the attorney general or prosecutor would have to take legal action); seek injunctions in Ingham County circuit court; issue cease and desist orders following investigation; deny, suspend or revoke licenses, and suspend or revoke registrations; require that restitution be made; assess civil fines; and censure a licensee or registrant. In conjunction with any examination or investigation, the commissioner could issue a subpoena; failure to comply with a subpoena would be a misdemeanor.

Following an investigation, the commissioner could summarily suspend a license or registration or issue a cease and desist order, as well as pursue any other available remedy, such as criminal prosecution or license revocation. A request to have a summary suspension lifted could be denied only if a hearing determined that an imminent threat of financial loss existed that required emergency action and continuation of the summary suspension. Cease and desist orders could be enforced through court injunctions obtained by the attorney general.

A complainant or the subject of a complaint could seek to have the matter resolved in an informal conference resulting in a settlement, consent order, waiver, default, or other method of settlement (including a suspension or revocation) agreed upon by the subject of the complaint and the commissioner. An informal conference would be held only if the person against whom the complaint had been filed agreed to it.

If the commissioner determined that a licensee or registrant was either intentionally or due to "gross or wanton" negligence not servicing mortgage loans in accordance with the bill or the terms of servicing contracts, he or she could appoint a conservator to manage the affairs of the licensee or registrant.

Additional Remedies, Penalties
It would be a misdemeanor punishable by a fine of up to $5,000, a prison term of up to three years, or both, to: fail to be licensed or registered as required by the bill; transfer interest in a mortgage loan prior to disbursement of at least 75 percent of the loan proceeds to the borrower; or fail to meet requirements that transfers of interest in mortgage loans be made through brokers or to investors who met certain criteria.

Any person could bring an action to obtain: a declaratory judgement that an act violated the bill; an injunction against a violation of the bill; or the greater of $250 or actual damages resulting from a violation of the bill, plus costs and attorney fees.

If the commissioner found that a person had violated the bill, he or she could, subject to the Administrative Procedures Act, assess a civil fine of up to $1,000 per violation; however, a fine could not be more than $10,000 for a single transaction resulting in more than one violation. Each individual injured by a violation would constitute a separate violation.

A violator would have to make restitution to each injured individual; the commissioner could suspend the violator's license or registration until restitution was made.

House Bill 4702
House Bill 4702 would amend the Occupational Code to excuse from regulation as a real estate broker or salesperson someone who was regulated under House Bill 4701 and who did not perform any other act requiring licensure as a real estate broker or salesperson.

MCL 339.2503

House Bill 4703
House Bill 4703 would amend the Uniform Securities Act to exempt from registration as a broker-dealer licensees and registrants under House Bill 4701. The exemption from broker-dealer registration would apply to the purchase or sale of mortgage loans as defined under House Bill 4701.

MCL 451.601

None of the bills could take effect unless all were enacted.

MORE

FISCAL IMPLICATIONS:

The Financial Institutions Bureau estimates that House Bill 4701 will present startup costs to the bureau in the first year of implementation, but that revenues will meet costs sometime in the third year. (6-8-87)

ARGUMENTS:

For:

The bills would enact reasonable, effective regulation of first mortgage lenders, servicers, and brokers who are not otherwise regulated under comprehensive regulatory acts. After the 1980 federal deregulation of first mortgage interest rates and fees, abuses in the mortgage industry (which had tended to be exorbitant fees to avoid state interest rate ceilings) were no longer combatable by application of state usury laws. After the 1981 enactment of the state's secondary mortgage loan act, abuses became more apparent in the first mortgage business, culminating with the Diamond Mortgage scandal where mortgages were assigned to more than one investor, astronomical fees were charged, and funds were not disbursed to borrowers.

State officials say that these abuses went undetected for so long because of fragmentary authority: the attorney general can seek injuctive relief under the Consumer Protection Act for unfair or deceptive practices, the commerce department's Corporations and Securities Bureau has authority to enforce securities laws, the Department of Licensing and Regulation oversees regulation of real estate brokers who arrange mortgages, the Financial Institutions Bureau monitors the activities of lenders regulated under various comprehensive laws (the Banking Code, the Credit Union Act, and so forth) and the secondary mortgage act, but no one had the responsibility or the authority to monitor and regulate the first mortgage industry. While A.J. Obie was registered as a securities broker-dealer and therefore under the jurisdiction of the Corporations and Securities Bureau, state officials say they had no authority to examine and monitor Diamond Mortgage. The bills would fill that regulatory gap, but without enacting dual regulation for those who are already adequately regulated. The problem is by no means in the past; with recent federal tax law changes, interest paid on first mortgages and home equity loans have become one of the few deductions remaining available to many, and the potential for abuse in the industry is greater than ever.

Against:

Some have challenged the need for the bills. The state already has a number of laws under which first mortgage transactions can be regulated. The Consumer Protection Act provides a broad range of authority to obtain relief from unfair practices. Those who negotiate mortgage loans are subject to the Occupational Code's regulation of real estate brokers, with its license and bonding requirements and various remedies. The buying and selling of mortgage loans is subject to the Uniform Securities Act, with its regulation of broker-dealers. Finally, there are the laws against fraud. Diamond Mortgage acted as a real estate broker, and A.J. Obie was a securities broker. Many suspect that the problem was not a lack of regulatory authority, but a lack of enforcement.

Against:

House Bill 4701 should more fully protect consumers. Mortgage loan abuses have largely been those of excessive fees, and the bill would not do enough to forbid them. It should expressly override (as the state may do) the federal preemption of limits on loan discount points and set specific limits on the size of the loan processing fee, which arguably represents discount points. In addition, the bill should not make it so hard for a consumer to check the accuracy of his or her account: a person should be able to obtain a complete ledger history, not just one for the previous twelve months. There is a need to protect individual mortgages. House Bill 4701 would provide that failure to comply would not affect the validity or enforceability of any mortgage loan not rendered invalid by another law. Would this mean that a mortgage would be foreclosable even though, for example, funds had not been disbursed to borrowers? The bill should establish claims and defenses for borrowers.

The bill fails to adequately address something that became a problem this spring as interest rates once again began to rise dramatically: mortgage lenders reneging on promises of certain interest rates. It would be a violation of the bill to fail to make a mortgage loan in accordance with a written agreement, but this is not enough. The problem had more to do with the loopholes written into those agreements: lenders were promising to preserve a given interest rate for a certain period of time, then as rates rose, delaying action on the mortgage application until the time period had expired.

Finally, the bill's licensure requirements and penalties are insufficient for the scope of the problem. A higher bond would offer better protection, and felony, rather than misdemeanor penalties, would be more appropriate for someone whose misdeeds cost people their life savings.

Response: The bill adequately protects consumers. The bill's standard for fees is that they represent reasonable and necessary costs. The specific fees listed by the bill are not subject to federal preemption, except perhaps for the loan processing fee, which, along with other fees, will be closely monitored by the Financial Institutions Bureau for reasonableness. Should abuses recur, the law can be changed. The key to the bill is strong monitoring capability that would discover problems before they reached disastrous proportions, along with provisions that would help to ensure that new licensees were reputable. Stiffer requirements such as increased bonding or net worth requirements would serve only to limit competition and entry into the industry. Moreover, the penalties that attach to what the bill calls "misdemeanors" actually are more in line with felony penalties. Finally, borrowers would be protected through provisions for restitution and other equitable remedies, and a requirement that at least 75 percent of a mortgage's proceeds be disbursed to the borrower before it can be sold on the secondary market.