

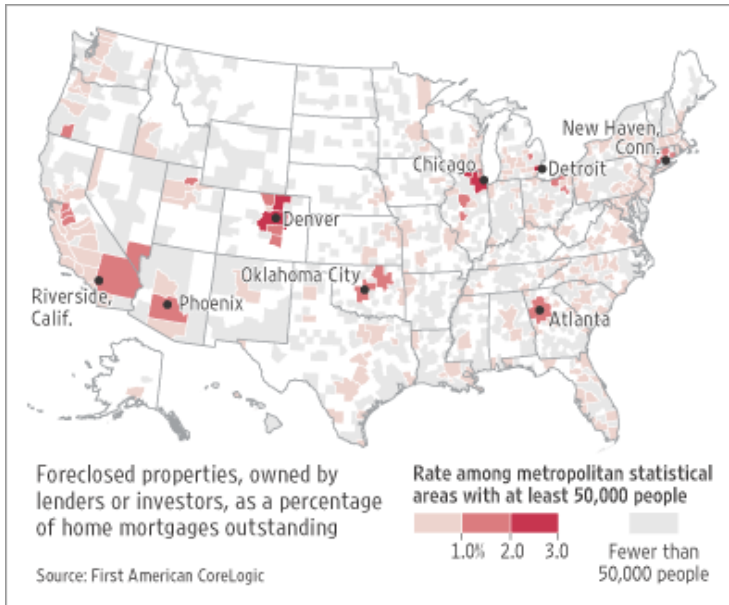
# ISSUE BRIEF

SENATE POLICY DEVELOPMENT AND RESEARCH OFFICE  
PREPARED IN CONJUNCTION WITH THE SENATE REPUBLICAN POLICY COMMITTEE

## Mortgage Industry Reforms

### *Introduction*

Fueled by unwise borrowing and predatory lending, foreclosures across the United States have dramatically increased over the last few years.



While the first wave of Americans to default on their home mortgages appears to be cresting, a second, far larger one is quickly building. Homeowners with good credit are falling behind on their payments in growing numbers, even as the problems with mortgages made to people with weak, or subprime, credit are showing their first, tentative signs of leveling off after two years of spiraling defaults. Alarming, the percentage of mortgages in arrears in the category of loans one rung above subprime, so-called alternative-A mortgages, quadrupled to 12 percent in April 2008 from a year earlier. Delinquencies among prime loans, which account for most of the \$12 trillion market, doubled to 2.7 percent in that time.<sup>1</sup>

The map at left suggests that while foreclosure rates in some U.S. metropolitan areas have soared,

Pennsylvania has so far avoided much of the mortgage crisis. Nevertheless, proactive Pennsylvania policymakers have worked to address and halt any future mortgage crisis in the state, while the U.S. Congress has dealt with the issue on a national level. This issue brief will summarize recent federal and state action.

### *Federal Action*

In July of 2008, the United States Congress passed, and the President signed, The American Housing Rescue and Foreclosure Prevention Act. While a detailed summary of the act can be found at <http://financialservices.house.gov/FHA.html>, the portion of the act called the “HOPE for Homeowners Act of 2008” creates a new program within the Federal Housing Administration (FHA) to back FHA-insured mortgages to distressed borrowers. The new mortgages offered to FHA-approved lenders will refinance abusive loans at a significant discount for homeowners facing difficulty meeting their mortgage payments. The program is built on five principles:

1. Long-term Affordability. The program is built on the idea, expressed by Federal Reserve Chairman Bernanke, that creating new equity for troubled homeowners is likely to be a more effective way to avoid foreclosures. New loans will be based on a family’s ability to repay the loan, ensuring affordability and sustainable homeownership.
2. No investor or lender bailout. Investors and/or lenders will have to take significant losses in order to benefit from the proceeds of the loans refinanced with government insurance. However, these losses would be less than the losses associated with foreclosure.

<sup>1</sup> The New York Times, August 4, 2008: [Housing Lenders Fear Bigger Wave of Loan Defaults](#)

3. No windfall for borrowers. Borrowers will share their new equity and future appreciation equally with FHA. Borrowers will pay for the FHA insurance.
4. Voluntary Participation. This will be a voluntary program. No servicers will be compelled to participate.
5. Restore confidence, liquidity, and transparency. Credit markets are fearful and frozen in part because banks and other financial institutions do not know what their subprime mortgages and related securities are worth. The uncertainty is forcing lenders to hoard capital and stop the lending necessary for economic growth. This program will create certainty and get markets flowing again.

### ***Pennsylvania Action – Department of Banking***

In 2003, the Pennsylvania House of Representatives adopted [House Resolution 364](#) (Dally) calling on the Pennsylvania Department of Banking to conduct a study of residential lending practices in Pennsylvania, to identify trends in foreclosures and to document lending practices disadvantageous to Pennsylvania consumers. The resulting study, “[Losing the American Dream: A Report on Residential Mortgage Foreclosures and Abusive Lending Practices](#)”, issued in March 2005, identified the abusive lending practices of the sub-prime mortgage industry as leading to many of Pennsylvania’s foreclosures. The report made a number of recommendations to address the problem including administrative and legislative actions. In response, the Department of Banking began the process of revising its regulations governing the proper conduct of lending and brokering in the mortgage loan business for individuals licensed under Pennsylvania’s mortgage licensing acts. The [final regulations](#) resulting from these efforts were published in the *Pennsylvania Bulletin* on December 20, 2008. Under the new regulations, mortgage lenders and brokers will be required to document and verify a borrower’s income, fixed expenses and other relevant factors to determine the borrower’s ability to repay the loan.

### ***Pennsylvania Action – Statutes***

In addition to these administrative actions, the General Assembly passed and the Governor signed into law six pieces of legislation during the 2007-08 Session addressing the problems in the mortgage industry, including many of the recommendations made by the Department of Banking. These measures included:

[Act 51 of 2008](#) created the Mortgage Property Insurance Coverage Act. The Act prohibits a lender from requiring a borrower, as a condition of obtaining or maintaining a secured loan, to obtain property insurance coverage that exceeds the replacement value of buildings and structures on the land used to secure the loan. It also specifies that a borrower on a loan secured by real property could not be required to insure the value of the land.

[Act 56 of 2008](#) amended Title 7 (Banks and Banking) and Title 18 (Crimes and Offenses) of the Pennsylvania Consolidated Statutes to regulate the mortgage loan industry. The Banking Code was amended to create a new chapter that consolidates state licensure of all first and second mortgage lenders, brokers and originators. The Act extends the current provisions of the Mortgage Brokers and Bankers and Consumers Equity Protection Act of 1989 to second mortgages and adds language to include mortgage originators as regulated entities under the Department of Banking. It outlines the licensure requirements for mortgage lenders, mortgage brokers, and mortgage originators, including fees and exceptions. The Crimes Code was amended to stipulate that persons operating a mortgage loan business without a license in violation of the licensure requirements would be committing a third degree felony.

[Act 57 of 2008](#) amended Act 6 of 1974, known as the Loan Interest and Protection Law (Usury Law). It adds a definition of “base figure,” namely \$217,873, to be adjusted annually for inflation by the Department of Banking through notice published in the *Pennsylvania Bulletin*. The definition of residential mortgage was amended to increase the principal included in the definition from \$50,000 or less to the base amount or less. Further, the maximum lawful interest rate set in Section 201 of the Act would not apply to an obligation to pay a sum of money in an original bona fide principal amount of more than \$50,000; an unsecured, uncollateralized loan in excess of \$35,000; or any business loan. It also provides for a penalty of \$10,000 per offense for any person who violates the provisions of the Act. The Act vests the Department of Banking with additional enforcement authority, including the ability to examine records and to issue subpoenas. If the Department determines that a person has violated the Act, it could suspend or revoke any license issued to the person by the Department or prohibit the person from working in any capacity related to activities regulated by the Department.

[Act 58 of 2008](#) amended the Department of Banking Code to permit the Department of Banking to release information on pending enforcement actions and fines against non-depository licensees (mortgage bankers and brokers). The Act also requires licensees to use and to pay processing fees for using a national electronic licensing system and requires all entities licensed by the Department of Banking to obtain criminal history checks. The Department of Banking is obligated to make public notices regarding applications; to receive comments and objections by third parties; and, to conduct hearings. The Department was given the ability to approve or disapprove an application without holding a hearing. A hearing would be held if an applicant or other person with standing protests the decision of the Department. The Act also clarifies the circumstances under which the Department could release information about a licensee who has been subject to sanctions.

[Act 59 of 2008](#) amended the Real Estate Appraisers Certification Act to create a new real estate appraiser trainee license and made changes necessary for compliance with the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 for federally-related transactions. The Act requires the State Board of Certified Real Estate Appraisers to issue an appraiser trainee license, without examination, to any person who meets the appraiser trainee educational requirements set by the Board and who does not already hold an appraiser credential. An appraisal trainee would have to operate under the direct supervision of one Certified Residential Appraiser or a Certified General Appraiser for the purpose of completing the experience requirement for an appraiser credential. The supervisory appraiser would have to be in good standing with the State Board, have at least five years of experience as a Certified Residential Appraiser or a Certified General Appraiser, and could not supervise more than three appraiser trainees. An appraisal trainee would be permitted to assist in the performance of any appraisal that is within the supervisory appraiser's scope of practice.

The Act added two more causes for disciplinary and corrective measures by the Board. These two causes include the suspension or revocation of the right to practice by a federal or state governmental agency or having been found by a civil court of competent jurisdiction to have performed a fraudulent appraisal. An additional change increased the penalty that the board could levy for violations from \$1,000 to \$10,000. The Act also modified the membership of the State Board of Certified Real Estate Appraisers. The Board is required to make its list of all persons licensed as appraiser trainees and certified real estate appraisers accessible on its internet website. The act does not preclude a licensed real estate broker from also holding an appraiser license or certificate and clarifies that Certified Residential Appraisers and Certified General Appraisers must conduct appraisals in accordance with criteria established by the Appraiser Qualifications Board of the Appraisal Foundation.

[Act 60 of 2008](#) amended the Housing Finance Agency Law to improve statewide mortgage oversight by requiring the Pennsylvania Housing Finance Agency (PHFA) to monitor foreclosure activity and trends in the Commonwealth using data gathered from foreclosure notices and mortgage assistance applications. The Act:

- requires PHFA to maintain an up-to-date list of approved consumer credit counseling agencies in each county and publish the list on its website;
- prohibits a mortgagee from taking any legal action, including mortgage foreclosure, prior to a final determination being made by PHFA on the mortgagor's application for emergency mortgage assistance;
- requires the foreclosure notice sent from the mortgagee to a mortgagor to include an itemized statement of the total amount past due on the mortgage;
- provides the mortgagor with thirty days, plus three days for mailing, to have a face-to-face meeting with a consumer credit counselor;
- requires mortgagees and other lenders to provide Act 91 foreclosure notices to PHFA;
- provides notification to a mortgagee if an administrative appeal has been filed;
- allows mortgage assistance applications to be submitted to PHFA beyond the thirty day period and permits PHFA to make a determination within sixty days of receiving the mortgagor's application;

- provides that mortgagees seeking mortgage assistance payments must provide, in a timely manner, necessary information to PHFA, including itemized statements of money due under the mortgage, fees incurred for attorneys, court costs, and expenses;
- provides that a mortgagee will receive monthly payments from PHFA and allows PHFA to buy out predatory loans when appropriate; and
- changes the assistance interest rate from nine percent to a mortgage interest rate established under the Usury Law.

### ***Pennsylvania Action - Legislation***

[Senate Bill 487](#) and [Senate Bill 488](#), both sponsored by Senator Pat Browne, would have amended the Mortgage Bankers and Brokers and Consumer Equity Protection Act and the Secondary Mortgage Loan Act of 1980, respectively, to provide additional licensing requirements of persons who are individual mortgage originators. Among other modifications, both bills would have:

- increased the fees for licensure and required an applicant for licensure to successfully complete a minimum of twelve hours of instruction and a testing program regarding the first mortgage loan business, the Loan Interest and Protection Law, and relevant federal law such as the Real Estate Settlement Procedures Act, the Truth in Lending Act, and the Equal Credit Opportunity Act. In addition, licensees would have been required to complete six continuing education credits annually;
- permitted the Department of Banking to deny a license if the applicant or certain individuals associated with the employer or applicant have been convicted of a crime of moral turpitude or a felony;
- required all advertisements by a mortgage originator to include information that he or she is licensed by the Department and the name of his or her employer;
- permitted the Department of Banking to examine all records of a licensee and to conduct administrative hearings on any matter pertaining to the Act; to render a decision concerning the suspension, revocation or nonrenewal of a license; to impose conditions on licenses; and to issue orders requiring restitution for actual damages or requiring an originator to cease and desist from prohibited activity;
- established that an individual engaging in the first loan mortgagee business without a license commits a third degree felony; and
- increased the penalty for violations of the Act from \$2,000 to \$10,000 for each offense.

Concerning the licensing requirements, Senate Bill 487 would have required the licensing of individual mortgage originators rather than just the companies they are employed by and required such mortgage originators to be employed and directly supervised by a licensed mortgage banker, mortgage broker or loan correspondent. The bill would have further required employees of licensees under the Consumer Discount Company Act who act as mortgage originators to be subject to the licensing requirements of this Act and hold their employers to the same requirements as mortgage bankers with regard to employment and supervision of mortgage originators. Also, the bill would have eliminated the real estate licensee, builder, and insurance company licensure exemptions. Finally, the bill would have restricted funds that a mortgage originator could accept, including any fees from consumers, in the mortgage originator's own name.

Senate Bill 488 would have required the licensing of persons who engage in the secondary mortgage business, defined as making or offering to make more than two secondary mortgages or becoming the holder of more than two or more promissory notes or mortgages in connection with a secondary mortgage in a calendar year. The bill would have also exempted various categories of individuals, businesses and government agencies, including regulated banks and credit unions, attorneys who act as secondary mortgage brokers, and authorized state and federal agencies, from the provisions of the Act. Both Senate Bill 487 and Senate Bill 488 passed the Senate (47-0) on March 11, 2008 and were referred to the House Commerce Committee on March 12, 2008. No further action was taken on the legislation before the end of the 2007-08 Legislative Session.