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SFA**BILL ANALYSIS**

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Senate Bill 708 (Substitute S-6 as reported)
Senate Bills 709 through 714 (Substitutes S-1 as reported)
Sponsor: Senator Valde Garcia
Committee: Banking and Financial Institutions

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RATIONALE

In recent times, the issue of "predatory lending" has gained national attention. Predatory lending practices take advantage of people who do not meet the traditional standards of creditworthiness, and must gain access to credit through the "subprime" market. It is widely reported that some lenders involved in the subprime mortgage market use aggressive sales tactics, confusing language, and blatant deception to pressure people with few assets into taking out loans they cannot repay. These loans often include excessive interest rates that cannot be justified by the level of risk involved, as well as exorbitant prepayment fees and other hidden costs. Some borrowers' rights are further limited by the inclusion of "mandatory arbitration" clauses. People engaging in unscrupulous lending practices reportedly target minorities, the elderly, and low-income individuals who do not qualify for traditional loans. These practices can lead to the loss of savings, businesses, and homes, which further devastates already economically depressed areas. According to a recent study by the Durham, North Carolina-based Self-Help Credit Union, \$9.1 billion per year is transferred from poverty-stricken areas into the coffers of mortgage companies through predatory lending practices. It has been suggested that lenders who target people with few assets and poor credit history should be strictly regulated to ensure the protection of borrowers.

CONTENT

Senate Bill 708 (S-6) would create the "Michigan Predatory Lending Practices Act" to:

- Prohibit lenders from engaging in certain practices in regard to a "covered mortgage loan".
- Describe provisions that a covered mortgage loan could not contain.
- Require lenders to give applicants a "Borrowers Bill of Rights" and a written notice regarding the value of receiving credit counseling before taking out a covered mortgage loan.
- Require lenders to give, or make available to, first-time applicants for a covered mortgage loan or the refinancing of a covered mortgage loan, a video informing them of their rights under the bill.
- Require the Office of Financial and Insurance Services (OFIS) to develop and make available a model program for financial education, and to produce a video about borrowers' rights.
- Describe actions the OFIS Commissioner would have to take if a person violated applicable Federal and State laws.
- Prohibit local units of government from regulating mortgage practices.

Senate Bills 709 (S-1) through 714 (S-1) would amend various statutes to provide that a financial institution or a licensee would be subject to and would have to comply with all of the requirements of the proposed Michigan Predatory Lending Practices Act. Senate Bills 709 (S-1), 710 (S-1), and 711 (S-1) would amend the Savings Bank Act, the credit union Act, and the Savings and Loan Act, respectively. Senate Bill 712 (S-1) would amend the Mortgage Brokers, Lenders, and Servicers Licensing Act, and would apply to a licensee

under that Act. Senate Bill 713 (S-1) would amend the Banking Code. Senate Bill 714 (S-1) would amend the Secondary Mortgage Loan Act and would apply to a licensee under that Act. Each bill is tie-barred to Senate Bill 708.

A more detailed description of Senate Bill 708 (S-6) follows.

Purpose

The bill specifies that the purpose of the proposed Act would be "to protect the residents of this state against lending and marketing practices and behaviors that are fraudulent, deceptive, misleading, or otherwise take an unfair advantage of persons seeking to obtain a covered mortgage loan".

A "covered mortgage loan" would be a credit transaction that was secured by the borrower's principal dwelling, and in which either of the following applied:

- The annual percentage rate at consummation would exceed by more than 8 percentage points for first-lien loans, or by more than 10 percentage points for subordinate-lien loans, the yield on U.S. Treasury securities having comparable periods of maturity to the loan maturity as of the 15th day of the month immediately before the month in which the creditor received the application for credit.
- The total points and fees payable by the borrower at or before loan closing would exceed 8% of the total loan amount or \$400, whichever was greater. The \$400 figure would have to be adjusted annually on January 1 by the annual percentage change in the consumer price index for the State that was reported on the previous June 1.

Prohibited Practices

The term "lender" would mean a depository institution (a bank, savings and loan association, savings bank, or credit union chartered under State or Federal law) or a licensee or registrant under the Consumer Financial Services Act, the Secondary Mortgage Loan Act, or the Mortgage Brokers, Lenders, and Servicers Licensing Act, and a holder of a home improvement finance contract under the Home Improvement Finance Act. "Lender" would not include a

licensee under the Motor Vehicle Sales Finance Act.

The bill would prohibit a lender from doing any of the following:

- Charging a fee for a product or service that was not actually provided to the borrower, or charging more than the amount charged by or paid to a third party for a product or service.
- Inserting or changing information on an application for a covered mortgage loan if the lender knew that the information was false and misleading and intended to deceive a third party that the borrower was qualified for the loan when, in fact, the third party would not approve the loan without the insertion or change.
- Conditioning the payment of an appraisal upon a predetermined value or the closing of the covered mortgage loan that was the basis of the appraisal.
- Financing as part of a covered mortgage loan single premium coverage for any credit life, credit disability, or credit unemployment.

A lender could not pay a contractor under a home improvement contract from the proceeds of a covered mortgage loan, except by an instrument payable to the borrower or jointly to the borrower and the contractor; or, at the borrower's election, through a third-party escrow agent according to terms established in a written agreement signed by the borrower, the creditor, and the contractor before the disbursement.

Also, a covered mortgage loan note could not contain blanks regarding payments, interest rates, maturity date, or amount borrowed to be filled in after the borrower signed the note.

Prohibited Loan Provisions

A covered mortgage loan could not contain any of the following:

- A payment schedule with regular periodic payments that caused the principal balance to increase.
- A payment schedule that consolidated more than two periodic payments and paid them in advance from the proceeds.
- An increase in the interest rate after default.

- A refund calculated by a method less favorable than the actuarial method for rebates of interest arising from a loan acceleration due to default.

A covered mortgage loan could not include a penalty for paying all or part of the principal before the due date, unless all of the following applied:

- The penalty could be exercised only for the first five years after the loan was consummated.
- The source of the prepayment funds was not a refinancing by the creditor or an affiliate of the creditor.
- At consummation, the borrower's total monthly debts, including amounts owed under the covered mortgages, did not exceed 50% of his or her monthly gross income, as verified by the borrower's signed financial statement, a credit report, and payment records for employment income.

Also, a covered mortgage loan could not include a demand feature that permitted the creditor to terminate the loan in advance of the original maturity date and to demand repayment of the entire outstanding balance, except in the following circumstances:

- The borrower committed fraud or material misrepresentation in connection with the loan.
- The borrower failed to meet the repayment terms of the agreement for any outstanding balance.
- Any action or inaction by the borrower adversely affected the creditor's security for the loan, or any right of the creditor in the security.

A covered mortgage loan with a term of less than five years could not include a payment schedule with regular periodic payments that, when aggregated, did not fully amortize the outstanding principal balance. This provision would not apply to a loan with a maturity of less than one year, if the loan were a "bridge" loan connected with the acquisition or construction of a dwelling intended to become the borrower's principal dwelling.

Information Provided by Lender

When a person applied for a covered

mortgage loan, the lender would have to give the applicant a written notice regarding the value of receiving credit counseling before taking out a covered mortgage loan and a list of the nearest available HUD-approved credit counseling agencies. The bill sets forth the language that the notice would have to contain.

The lender also would have to give the applicant a Borrower's Bill of Rights, informing the applicant of his or her rights to the following:

- To shop for the best loan for the applicant and compare charges of different brokers and lenders.
- To be informed about the total cost of the loan, including the interest rate, points, and other fees.
- To know what fees were nonrefundable if the applicant withdrew the application.
- To ask the mortgage broker to explain what the broker would do for the applicant.
- To know how much the broker was getting paid by the applicant and the lender for the loan.
- To ask questions about charges and loan terms.
- To know the reason if the application was turned down.
- To receive the HUD settlement costs booklet "Buying Your Home".

The Bill of Rights also would have to inform the applicant of the right to a credit decision not based on his or her race, color, religion, national origin, sex, marital status, or age, or whether any income was derived from public assistance.

A lender would have to provide each person who, for the first time, was applying for a covered mortgage loan or the refinancing of a covered mortgage loan, a video informing the applicant of his or her rights under the bill. The lender could provide the applicant with either a copy of the video or the opportunity to view it at a convenient time and location.

At least three days before closing, a lender would have to provide the borrower all information required by Federal and State laws (i.e., one or more of the laws or regulations of this State or the Federal government that regulate or apply to a mortgage loan or a lender when soliciting,

brokering, making, servicing, or collecting a mortgage loan, including the following Federal laws: the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Equal Opportunity Act, the Fair Housing Act, the Fair Credit Report Act, the Homeowners Protection Act of 1998, and the Fair Debt Collection Practices Act; as well as the following Michigan laws: the Consumer Protection Act, the Consumer Financial Services Act, the Mortgage Brokers, Lenders, and Servicers Licensing Act, the Secondary Mortgage Loan Act, and the Home Improvement Finance Act).

OFIS Responsibilities

By June 1, 2003, the Office of Financial and Insurance Services, in the Department of Consumer and Industry Services, would have to develop and make available to local units of government, financial institutions, and other interested persons one or more model programs for financial education. The program would have to be designed to teach personal financial management skills and the basic principles involved with saving, borrowing, investing, and protection against predatory and other fraudulent lending practices.

After consultation with representatives of lenders, consumers, and other interested parties, the OFIS Commissioner would have to establish guidelines for the content and production of the video that lenders would have to provide to loan applicants.

Violations

The Commissioner could conduct examinations and investigations of a lender over whom the Commissioner had regulatory authority, as necessary to determine whether the lender was soliciting, brokering, making, servicing, or collecting covered mortgage loans as required by Federal and State law.

If the Commissioner determined, after an investigation, that a person was soliciting, brokering, making, servicing, or collecting covered mortgage loans in violation of Federal and State law, the Commissioner would have to do one or more of the following:

- Bring an action against the person (as described below).
- Enforce the penalties and remedies under

the law, if the person were chartered, licensed, registered, regulated, or administered by the Commissioner under a law of this State.

- Forward a complaint to the appropriate Federal or State regulatory or investigatory authority, if the person were not chartered, licensed, registered, regulated, or administered by the Commissioner.

The Commissioner could bring an action against a person to do one or more of the following:

- Obtain a declaratory judgment that a method, act, or practice of the person as a violation of the bill.
- Enjoin the person who was engaging or about to engage in a method, act, or practice in violation of the bill.
- Obtain a civil fine of up to \$10,000 for a first offense or up to \$20,000 for a second or subsequent offense.
- Order the person to make restitution to the person or people who suffered a violation of the bill.

A lender would not be liable for a violation if the lender showed that the violation was an unintentional and bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid the error. Examples of a bona fide error would include clerical, calculation, computer malfunction, programming, or printing errors. An error in legal judgment with respect to a lender's obligations would not be a bona fide error.

A lender also would not be liable for a violation if, within 60 days after the violation was discovered and before the Commissioner instituted an action, the lender notified the borrower of the violation and corrected it in a manner that, to the extent reasonably possible, restored the borrower to the position he or she would have been in if the violation had not occurred.

A lender alleged to have violated the bill would have the burden of proving that the lender was not liable.

Preemption

The bill specifies that the Federal and State governments "solely regulate" the business of

soliciting, brokering, making, servicing, and collecting mortgage loans in Michigan and the manner of conducting that business. A municipal corporation or other political subdivision of this State could not enact or enforce an ordinance, resolution, or regulation that pertained, directly or indirectly, to the solicitation, brokering, making, servicing, or collection of mortgage loans.

As used in these provisions, "mortgage loan" would mean a loan secured by a first or subordinate mortgage covering real property located in Michigan used as the borrower's principal dwelling and designed for occupancy by four or fewer families.

Conformity with Federal Law

All covered mortgage loan documents and disclosures required by the bill would have to conform with Section 1632 of the Federal Truth in Lending Act (15 USC 1632). (That section prescribes the manner in which information must be disclosed.)

Proposed MCL 487.3435 (S.B. 709)
Proposed MCL 490.10a (S.B. 710)
Proposed MCL 491.737 (S.B. 711)
Proposed MCL 445.1674a (S.B. 712)
Proposed MCL 447.14206 (S.B. 713)
Proposed MCL 493.74a (S.B. 714)

BACKGROUND

Various local and state governments have passed ordinances and laws over the past several years to provide greater protection for people vulnerable to predatory lenders. Many local governments have instituted ordinances prohibiting financial institutions engaging in predatory lending practices from doing business with the municipality. North Carolina, California, Illinois, Georgia, and New York all have passed predatory lending legislation within the last three years. As a result of increased attention on predatory lending, the U.S. Senate held a series of hearings on the issue in 2001, which led to the introduction of legislation in both chambers of Congress.

In October 2002, Michigan and 19 other states were awarded \$484 million from a lawsuit against Household Financial, which was accused of abusive lending practices. The direct restitution amount, of which Michigan

will receive \$10 million to \$14 million, is said to be the largest award ever in a state or Federal consumer case. The settlement also may provide a blueprint for national standards, as laws and regulations concerning predatory practices currently vary from state to state. In 2000, the U.S. Department of Treasury and U.S. Department of Housing and Urban Development released a joint report, *Curbing Predatory Home Mortgage Lending*, in which they outlined a four-point plan for combating abusive lending practices.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Under this legislation, lenders would be prohibited from falsifying loan applications and misrepresenting the terms and conditions of loans. Additionally, they would have to educate their clients about the services and products they receive and their consumer rights, by encouraging credit counseling. The availability of this knowledge, combined with the financial education and borrower's rights information provided through OFIS, would empower borrowers to make good choices concerning loans. The fines and restitution that lenders could be required to pay for violations also would offer added protection for borrowers.

Opposing Argument

This package of bills lacks crucial consumer protections. Credit counseling for first-time borrowers would be only encouraged, not required. The Borrowers Bill of Rights provided by a lender and the videotape developed by the OFIS would provide basic information only; they would not provide sufficient information for a borrower fully to understand the loan process and make prudent decisions. The Attorney General would not be granted enforcement authority and lenders would not be required to file annual reports on the number of borrowers who defaulted on their loans. Prepayment penalties would be only limited, not prohibited, and nothing would prohibit a fee to modify, renew, or extend an existing mortgage loan. There also would be no protection against "flipping", a practice in which a lender encourages repeated financing of a loan, tacking on excessive fees each time.

A lender would be required to provide disclosures only in accordance with State and Federal law; it would not have to disclose whether a loan had a variable interest rate and how that would affect monthly payments. Should a borrower have a complaint against a lender, he or she would have no private cause of action but would have to go through mandatory arbitration. There is nothing in the legislation stopping lenders from granting subprime loans to people who qualify for prime loans, nor is there a suitability test to determine a potential borrower's ability to pay back a loan. All this legislation would do is preempt local ordinances, which may contain stronger borrower protection.

Response: While a small group of subprime lenders engages in abusive practices, most subprime lending benefits borrowers. Subprime lending has resulted in the expansion of access to credit for people who do not qualify for "prime" loans. If regulations were too restrictive, they could hinder the ability of law-abiding lenders to provide necessary services to people with blemished credit histories. Some practices labeled "predatory", such as balloon payments and prepayment penalties, are actually good for borrowers when used appropriately. Predatory lenders already ignore existing laws; they will continue doing so regardless of stricter regulations. Laws that are excessively constraining merely will limit consumer choice, reduce the availability of credit to borrowers, and increase the cost of home ownership.

Legislative Analyst: Julie Koval

FISCAL IMPACT

Senate Bill 708 (S-6) would require OFIS to develop model programs for education and a video regarding borrowers' rights. These additional responsibilities would increase the cost of regulating this industry, which would be covered by the existing fee revenue. Additionally, the bill would establish civil fines for violations. The fines would be deposited into the General Fund. The amount of revenue generated would depend on the number of fines assessed.

Senate Bills 709 (S-1) through 714 (S-1) would have no fiscal impact on State or local government.

Fiscal Analyst: Maria Tyszkiewicz

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.