Subprime lending & Foreclosure Crisis

Legislative Responses

Assembly Committee on Banking and Finance
The Mortgage Crisis – Facts and Figures

- A **Credit Suisse** report this spring predicted that 6.5 million loans will fall into foreclosure over the next five years, reaching more than 8 percent of all U.S. homes.

- Foreclosure filings – including default notices, auction sale notices and bank repossessions – were reported on 303,879 U.S. properties during August, a 12 percent increase from the previous month and a 27 percent increase from August 2007.

- One in every 130 California households received a foreclosure filing in August for a total of 101,724 filings (the nation's highest total), up 76 percent from August 2007 and up more than 40 percent from July 2008.

- California cities accounted for eight of the top 10 metro foreclosure rates out of the 230 metro areas tracked in the August report. Stockton Merced, Modesto, Vallejo-Fairfield Riverside-San Bernardino Bakersfield, Salinas-Monterey and Sacramento.
In 2007 the U.S. Conference of Mayors released a report that highlighted the following results of the foreclosure crisis:

- U.S. GDP will be $166 billion lower.
- Nationwide homeowners will see property values decline by $1.2 trillion in 2008.
- Foreclosures in 2008 will increase by at least 1.4 million nationwide.
- Home price declines in California will range as high as 16%.
- California could lose as much as $2.96 billion in property tax revenue, $994 million in sales tax revenue and $39 million in transfer taxes.
It is estimated that up to 8.5 million homeowners in 2008 will be have negative equity in their homes, up from 3.5 million in 2007.
Beginning in 2007 the legislature conducted several informational hearings to examine the first wave of the crisis.

California regulators implement federal guidance relating to non-traditional loan products.

Regulators begin collecting loss mitigation data.

By the end of the year several large mortgage lenders have collapsed.
November 1, 2007: Assembly Banking & Finance Committee conducts a four hour hearing in Los Angeles to examine the subprime crisis and its impact on the community.

Conclusions from hearing:

- Lack of uniform reporting of foreclosure and loss mitigation data.
- Community groups and counseling organizations were understaffed and under-funded to respond to the problem.
- Loan services and lenders were not yet fully able to grasp the scale of the problem.
- Without fundamental reform in the subprime market the crisis could happen again.
2008

Over 15 bills related to the crisis are introduced.

**AB 69 (Lieu) – Mortgage Lending: reporting.** Clarifies the authority of the Department of Corporations to request loan modification data, on a monthly basis, from their licensees who are servicing loans.

**AB 180 (Bass and Lieu) – Mortgages: foreclosure consultants.** Prohibits a foreclosure consultant from entering specified pre-foreclosure agreements with a homeowner, allows a homeowner to cancel within five days of signing a contract with a foreclosure consultant, and requires the foreclosure consultant to maintain a surety bond. Also has a translation provision to allow owners to request a completed copy of the contract if any language described in Civil Code Section 1632 (Spanish, Chinese, Tagalog, Vietnamese, and Korean).
AB 529 (Torrico) – Mortgages: adjustable interest rates: notification. This bill requires a borrower to receive notice if their loan is scheduled to switch from an initial fixed rate to an adjustable rate, or set to reset to a fully amortizing loan. This notification must occur between 90 and 120 days before the loan is scheduled to switch or reset.

AB 1830 (Lieu) – Lending. Enacts the Subprime Lending Reform Act (Act). Enacts prohibitions, requirements and restrictions for higher priced loans. Also provides that mortgage brokers owe a fiduciary duty to borrowers.

AB 1837 (Garcia) – Consumer loans: subprime and nontraditional loans. Limited prepayment penalties and Yield Spread Premiums for subprime loans.

AB 2161 (Swanson) – Loans: consumer complaints. This bill requires the Department of Real Estate, the Department of Financial Institutions, and the Department of Corporations to report to the Legislature on consumer complaints related to nontraditional loans.
**AB 2187 (Caballero) – Mortgages: foreclosure.** This bill imposes certain requirements on mortgage lenders that are foreclosing on property.

**AB 2359 (Jones) – Loans.** Provides that an originator, beneficiary, trustee or assignee shall not require as a condition of an agreement regarding a covered loan, subprime loan, or non-traditional loan that the applicant waive any duties, remedies, or forums of California law with respect to a residential mortgage or mortgage foreclosure.

**AB 2880 (Wolk) – Mortgage lending.** Specifies that mortgage brokers have a fiduciary responsibility to borrowers and requires mortgage brokers to maintain a surety bond.
**AJR 45 (Coto) – Mortgage loans**: federal conforming and FHA mortgage loan limits. This resolution memorializes the Congress of the United States to enact, and the President of the United States to sign, a permanent increase in the conforming mortgage loan limit.

**AJR 59 (Solorio) – California subprime mortgage foreclosures.** This resolution urges the President of the United States and Congress to require more oversight of mortgage lenders and loan servicers and increase disclosures and enforcement of mortgage laws.

**SB 1053 (Machado) – Real estate: brokers and salespersons.** Requires real estate brokers that make, arrange, or service residential mortgage loans to notify the Department of Real Estate (DRE) of their business activity, and requires brokers to file certain reports and statements with DRE.

**SB 1054 (Machado) – Real estate: brokers and salespersons.** Allows the Department of Real Estate (DRE) to prohibit, bar or suspend a real estate salesperson or broker from participating in any business activity relating to real estate for up to 36 months.
SB 1055 (Machado)- Taxation: cancellation of indebtedness: mortgage debt forgiveness. This bill would provide further conformity to federal income tax laws by conforming to specified provisions of the federal Mortgage Forgiveness Debt Relief Act of 2007, relating to the exclusion of the discharge of qualified principal residence indebtedness, as defined, from a taxpayer’s income if that debt is discharged after January 1, 2007, and before January 1, 2009, as provided.


SB 1448 (Scott) – Real estate brokers and salespersons: fines. This bill increases the maximum fine for an unlicensed person acting or advertising themselves as a real estate broker or a real estate salesperson from $10,000 to $20,000 and for an unlicensed corporation from $50,000 to $60,000, and requires any fine collected in excess of $10,000 from an individual or in excess of $50,000 from a corporation be deposited into the Real Estate Fraud Prosecution Trust fund if one exists in the county where the conviction occurs. Status: Chapter 156, Statues of 2008

SB 1604 (Machado)- Finance lenders and residential mortgage lenders. This bill would require that applicants for a license to engage in the business of residential mortgage lending, as specified, show a minimum tangible net worth of $50,000, for brokers, and $250,000, for finance lenders. The bill would require that all other applicants for a license show a minimum tangible net worth of $25,000, for brokers, and $100,000, for finance lenders. This bill was later gut & amended.
Senate Bill 1137 and Assembly Bill 1830

- SB 1137 and AB 1830 take different approaches to mitigate the subprime crisis.

- SB 1137 responds to the current problems such as foreclosure and loan modifications.

- AB 1830 seeks to prevent this crisis from happening again.
SB 1137 (Perata)

- Requires contact with borrower at least 30 days prior to filing of notice of default (NOD).

- Requires the offer of a face-to-face meeting with a referral to a HUD certified counselor.

- Requires the trustee, mortgagee, or beneficiary to maintain a toll-free number that will provide access to a live person during normal business hours.

- Makes legislative findings and declarations regarding loan modifications.
Requires that upon posting a notice of sale, the borrower must receive a notice (in English, Spanish, Chinese, Tagalog, Vietnamese, or Korean) that states the following:

"Foreclosure process has begun on this property, which may affect your right to continue to live in this property. Twenty days or more after the date of this notice, this property may be sold at foreclosure. If you are renting this property, the new property owner may either give you a new lease or rental agreement or provide you with a 60-day eviction notice. However, other laws may prohibit an eviction in this circumstance or provide you with a longer notice before eviction. You may wish to contact a lawyer or your local legal aid or housing counseling agency to discuss any rights you may have."
SB 1137-continued

- Requires maintenance of vacant property with a potential of a $1,000 per day fine. The government entity that issues the fine must give notice and an opportunity to correct the violation.

- Provides a tenant or sub-tenant of a rental unit with 60 days notice after a property is sold into foreclosure before the tenant may be removed.

- Sunsets on January 1, 2013.
AB 1830 (Lieu, Bass, Nava & Wolk)

- Uses the same definition of “Higher priced mortgage loans” as Regulation Z.

- Prohibits Steering:
  AB 1830 directly prohibits a broker from steering borrowers to accept a loan at a higher cost than that which the consumer could otherwise qualify for.

- Eliminates Compensation Incentives That Led To Riskier Loans:
  AB 1830 eliminates this incentive by requiring that regardless of who pays the broker (borrower, lender or third party), the compensation must be the same. This will ensure that a broker can receive no more from a lender than the borrower would pay to the broker in up-front costs.

- Directly Prohibits Deceptive Statements:
  AB 1830 contains a prohibition against brokers and lenders from making false or deceptive statements connected with a subprime loan.
Enacts Strong Fiduciary Duty Standard:
AB 1830 codifies a fiduciary duty standard for mortgage brokers across all loan products. A violation of this duty will make a broker subject to a violation of their license as well as strong civil liability and penalties.

Bans Negative Amortization Loans:
AB 1830 prohibits any subprime loan that could lead to negative amortization. The pool of borrowers in the subprime market is already riskier. Allowing an extremely risky product such as a negative amortization loan to be offered to this pool is not sound policy.

Caps Prepayment Penalties:
AB 1830 builds on the provisions of Regulation Z and caps the amount of the penalty to no more than 2% of the principal balance in year one of the loan, and no more than 1% of the principal balance in the second year.

AB 1830 also prohibits anyone who arranges a subprime loan from receiving increased compensation for originating a loan that includes a prepayment penalty.
AB 1830-continued

- Provides for a civil penalty of up to $10,000 for a knowing and willful violation.
- Provides borrowers with a private right of action and the ability to recover attorney's fees.
- Provides that a licensing agency may prohibit licensees from engaging in acts or practices in connection with subprime loans that the agency finds to be unfair, deceptive, or designed to evade the law.
- Provides explicit authority for California regulators (DRE, DOC & DFI) to enforce provisions of federal lending laws (TILA, RESPA & HOEPA) against their licensees and furthermore provides that violations of federal lending laws are also a violation of that person's license.
- Operative date of July 1, 2008
On January 9, 2008 the Federal Reserve Board published proposed rules that would amend Regulation Z. The proposal included new restrictions and requirements for mortgage lending and servicing designed to protect consumers from abusive mortgage product features and deceptive acts.

The Board received 4700 comments.

Final rule will become operative October 7, 2009
Higher-priced loan Definition:

The proposal defined higher-priced mortgage loans as a consumer credit transaction secured by the consumer's principal dwelling for which the APR is 1.5 percentage points above the average prime offer rate on comparable transactions for first-lien loans, and 3.5 percentage points for subordinate-lien loans. This definition excludes reverse mortgages, construction-only loans and bridge loans.

Ability to Repay:

The proposal prohibited creditors from extending credit without regard of the borrower's ability to repay from sources other than collateral.

Prepayment Penalties:

The final rule bans PPPs for higher priced loans if the payment can change with the first four years after consummation. With most adjustable rate loans ranging from two to three years, this provision effectively bans PPP for ARMS. Additionally, for loans that do not have a payment change the PPP is limited to the just the first two years after consummation.
**Escrow Accounts:**
Requires creditors to establish an escrow account for property taxes and homeowners insurance on higher-priced loans secured by the first lien on the principle dwelling.

**Coercion of Appraisers:**
The Board proposed to prohibit creditors and mortgage brokers and their affiliates from coercing, including, or otherwise encouraging appraisers to misstate or misrepresent the value of a consumer's principle dwelling.

**Servicing Abuses.**
The Board proposed to prohibit certain practices of servicers. The proposal provides that no servicer shall:

- Fail to credit a consumer's periodic payment as of the date received.
- Impose a late fee or delinquency charge where the late fee or delinquency charge is due only to a consumer's failure to include in a current payment a late fee or delinquency charge imposed on earlier payments.
- Fail to provide an accurate payoff statement within a reasonable time of request.
Future Legislative Actions

- HR 3221 contains a provision known as the Secure and Fair Enforcement (SAFE) for Mortgage Licensing Act of 2008.

- The SAFE Act requires that all loan originators be licensed.

- This will require state legislation to conform to requirements of the SAFE Act.
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