

**“Licensing and Registration of the Mortgage Industry”**  
Title V, Requirements for Mortgage Brokers of HR 1295

Subcommittee on Housing and Community Development  
Committee on Financial Services  
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Testimony of  
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Chairman Ney, Mrs. Waters, Members of the Committee, thank you for inviting me here to testify today regarding mortgage brokers, predatory lending and appropriate federal and state regulations. I am the Director of Mountain State Justice, a non-profit legal services program<sup>1</sup> in Charleston, West Virginia which exclusively represents low income people at no cost to them. We have a very active caseload of low income homeowners who are the victims of predatory lending and are in danger of losing their homes because of the unscrupulous and illegal practices of mortgage brokers, mortgage lenders and servicers.

My primary purpose in coming here today is to convince you and your colleagues to pass only legislation which safeguards existing state law currently employed to save homes from foreclosure due to predatory lending. While we would also be happy to see Congress pass legislation which effectively limited the explosion of home equity theft, our first message to you is “Don’t deplete the existing remedies we have to save homes.” **Passage of Title V of H.R. 1295 would strip away effective remedies against unscrupulous mortgage brokers, without replacing it with any meaningful protections. The result would be a damaging increase in foreclosures of homes.**

In this written testimony I will first explain the importance of state laws in our efforts to save homes put at risk by the fraudulent and unconscionable practices of mortgage originators. Then, I will explain how the current language of Title V of H.R. 1295 would increase predatory lending, causing the loss of more equity and homes. In the last section of this written testimony, I will respond to the questions posed in the written invitation by Chairman Ney.

### **The Importance of State Law Remedies in Protecting Homeowners from Broker Abuse**

In my practice at Mountain State Justice we currently represent more than 600 homeowners in 60 predatory mortgage cases.<sup>2</sup> In these cases it is the state laws that give homeowners the protection from predatory mortgage brokers. In West Virginia, there are a number of significant consumer protections applicable to mortgage loans originated by brokers. Title V of HR 1295 would appear to preempt West Virginia protections for homeowners against overreaching and abusive broker activities including:<sup>3</sup>

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<sup>1</sup>Mountain State Justice is privately funded, largely through attorneys’ fees earned by the staff through the representation of its-low income clients. I have been the Director of the program since its inception in 1996. Previously I was the Directing Attorney of Appalachian Research and Defense Fund of West Virginia, a legal services program with which I was affiliated since 1971. As a legal services attorney for over thirty years, I have handled thousands of cases representing low income people in West Virginia. During this time, in addition to a significant consumer law practice, I have also worked on cases involving education funding, institutional conditions, mental health services, juvenile justice issues and worker safety.

<sup>2</sup>Currently, there are approximately fifty-five individual cases and five group cases in my consumer law practice.

<sup>3</sup>Sec. 501(b)(2).

- Brokering a loan in excess of the market value of the home;<sup>4</sup>
- Brokering a non-amortizing loan;<sup>5</sup>
- Prohibiting brokers from participating in compensation arrangements with appraisers which influence independent judgment;<sup>6</sup>
- Brokering an unconscionable loan, i.e., one without economic benefit to an unsophisticated consumer;<sup>7</sup>
- Limitations on exorbitant broker fees which prohibit combined fees (all points and fees except unrelated third party closing costs) of more 5% without a yield spread premium, or 6% with a yield spread premium;<sup>8</sup>
- Brokering a real estate loan which includes a security interest in an unattached mobile home;<sup>9</sup>
- Brokering a loan with excessive closing attorneys fees, and duplicative broker/lender fees;<sup>10</sup>
- Brokering a loan in which the borrower was asked to sign loan documents with blanks to be filled in after consummation.<sup>11</sup>

These restrictions are among other statutory and common law limits on broker activities which have in the last few years weeded out, to some extent, the most exploitive brokers in the state. There is still much work to be done to protect homeowners from wrongful broker activities, but these enforcement actions are currently only available through the state law. Title V of H.R. 1295 threatens to cripple our abilities to protect homeowners.

State law remedies are especially important because of the lack of meaningful enforcement of existing federal laws. There is a prohibition against unfair and deceptive practices in Section 5 of the FTC Act.<sup>12</sup> In the 1970s, one of the worst abuses facing homeowners was the problem caused by door to door home improvement salesmen who would sign people up for high

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<sup>4</sup>W.V. Code Section 31-17-8(m)(8).

<sup>5</sup>W.V. Code Section 31-17-8(m)(7).

<sup>6</sup>W.V. Code Section 31-17-8(m)(2).

<sup>7</sup>W.V. Codes Section 46A-2-121.

<sup>8</sup>W.V. Code Section 31-17-8(m)(4).

<sup>9</sup>W.V. Code Section 31-17-8(m)(5).

<sup>10</sup>W.V. Code Section 31-17-8(m)(1).

<sup>11</sup>W.V. Code Section 31-17-8(j)(6).

<sup>12</sup>15 U.S.C. Section 45.

cost home secured loans even when work was either shoddy or not done at all.<sup>13</sup> We made numerous requests to the FTC for assistance in limiting the abuses in this industry. I even brought suit against the FTC to secure enforcement of their own prohibition against unfair and deceptive trade practices (there is no private right of action under this federal prohibition). Despite these repeated attempts, we were unsuccessful. The FTC simply lacks the resources to do anything significant on individual cases. So we turned to the courts for redress. During my 35 years of representing defrauded homeowners, ***thousands of homes have been saved from the foreclosure sale in West Virginia primarily through the application of state law.***

A few examples of the importance of state law claims in saving homes, or equity, after unscrupulous mortgage brokers have victimized homeowners, include:

- Ms. S.S., an elderly widow from Huntington, West Virginia. was flipped seven times by the same broker in a period of ten years. On every single occasion the loan was based on an increased – and fraudulent – appraisal, new fees and closing costs adding to the principal of the loan. Each refinancing became less affordable to Mrs. S.S., until the final loan called for payments completely beyond her means. Action against the mortgage broker and the lender, using state law claims including unconscionable inducement, as well as the failure to comply with other state law requirements on brokers. The resolution of the case allowed Ms. S.S. to keep her home free of all liens, in addition to receiving a cash settlement.
- An elderly Parkersburg woman named Mrs. H. was solicited by a broker who promised a mortgage loan that would lower her monthly payments. The broker charged fees far in excess of the statutory maximum, and lent her more than her house was worth. Mrs. H. pursued the action successfully on behalf of a class of 115 similar loans based on state law claims of making a loan in excess of the market value of the home and charging excess broker fees. Mrs. H was able to keep her home free of all liens and the excess broker fees are being returned to all the homeowners in the class.
- Mr. and Mrs. A. from Bluefield, West Virginia, ages 79 and 81, owned the home in which they had raised seven children free of all liens. He was disabled miner after a lifetime of working in the mines. She was still working in a bakery. They were solicited by a broker to take out a loan to pay off a few bills. The broker obtained a bogus appraisal of \$69,000 on a home worth less than \$10,000 to secure a loan Mr. and Mrs. A could not possibly afford. They were foreclosed upon and forced out of their home. The case is in litigation with pending state claims including brokering a loan in excess of the market value of the home and failure to make broker disclosures. The resolution will result in the return of the home.

Please do not confuse my statements regarding the importance of state laws and the need

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<sup>13</sup>The aluminum siding salesmen of the 1970s are the loan brokers of today.

for improved enforcement of existing federal law into anything other than a strong endorsement for improved substantive laws to address predatory lending. Unfortunately, no amount of enforcement of existing laws will change the underlying dynamics of the mortgage market, which provide sufficient enticements to encourage the continued pillaging of the home equity of unsophisticated homeowners. Congressional changes to the intricate interplay of federal and state regulation of the mortgage industry created the current mess – strong new federal laws are necessary to undue this damage. Unfortunately, H.R. 1295, in its entirety, or just Title V, would exacerbate the problem of predatory lending.

The problem of abusive home lending is now much greater than it has ever been in the past because of the exploitations caused by the proliferation of free market commissioned compensated loan brokers. These broker misrepresentation-induced loans replace local bank loans with fair terms and little risk of home loss. Some brokers routinely lead homeowners into loans with promises of savings that seldom materialize. The problem is that neither the marketplace, nor the combined effect of federal and state laws, create incentives to brokers to make loans that are performing and fair.

**Passage of Title V of H.R. 1295 would increase predatory lending, causing the loss of more equity and homes.**

Title V of H.R. 1295 is not a consumer protection provision. Instead, it appears that it would:

1. Preempt protective state law provisions limiting mortgage broker activities;
2. Exempt from coverage under Title V's provisions the majority of all mortgage brokers;
3. Fail to apply any meaningful protections even for those few mortgage brokers to whom it would be applicable.

**Preemption of State Laws.** As currently written, Title V of H.R. 1295 appears to preempt state laws which regulate mortgage brokers. All requirements on mortgage brokers appear to be eliminated because of the bill's basic premise – that each state law must be uniform with the requirements in this federal bill.<sup>14</sup>

The requirement for uniformity appears to leave states little room for additional protections or requirements. A parsing of the requirements of Title V of H.R. 1295 appears to provide that the rules applicable to mortgage brokers in a state that does not have an entirely

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<sup>14</sup>The word “uniform” means identical. The dictionary definition for uniform is: 1) Always the same, as in character or degree; unvarying; 2) Conforming to one principle, standard, or rule; consistent; 3) Being the same as or consonant with another or others; 4) Unvaried in texture, color, or design.

uniform law would be preempted.<sup>15</sup> It thus appears that any state law that used the federal law as a floor, but added more, substantive protections, would be preempted.

**Exemption of Most Mortgage Brokers.** At the same time, Title V appears to exempt the huge majority of mortgage brokers even from the minimal regulation that is applicable under the uniformity standard in the title. There is a long list of persons and entities which are exempted altogether from regulation under the uniform state laws and their federal counterpart:

- Most significantly, **any person who is a creditor under the Truth in Lending Act and makes more than \$1,000,000 in loans per year**, which covers almost any mortgage broker who might otherwise not already be exempted. This essentially permits brokers to avoid all state and federal regulation simply by table funding a few loans a year (closing loans in their own name with immediate sale). Some brokers now use this approach.
- Not only are all **banks, savings and loans, and credit unions exempted**,<sup>16</sup> but so are **their subsidiaries and affiliates**. This is a significant extension of the preemption rules currently applicable to federally chartered financial institutions, which are generally limited to the preemption of state laws for the institutions themselves and their operating subsidiaries. Allowing affiliates – which are not subject to any other state or federal regulation – to be exempt from the rules leaves those institutions and their employees completely unregulated.

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<sup>15</sup> This conclusion is gleaned from reading the following subsections of Title V together:

The Federal mortgage broker requirements established pursuant to this title shall apply only with respect to state that, upon expiration of the 3-year period beginning on the date of the enactment of this Act, have not enacted and do not have in effect *uniform state laws and regulations described in subsection (b)*. (Emphasis added.)

**Sec. 501(a).**

If, at any time, the Secretary determines that a State no longer has in effect laws and regulations described in subsection (a) *or the uniformity necessary to comply with subsection (a) no longer exists with respect to a state, the Federal mortgage broker requirements shall take effect with respect to such State* 2 years after the date on which such determination was made, unless the State has in effect such laws or regulations, or the uniformity necessary to comply with subsection (a) is satisfied, before the expiration of such 2 year period. (Emphasis added.)

**Sec. 501(d).**

Not later than 3 years after the date of the enactment of this Act, the Secretary of Housing and Urban Development shall, by regulation and in consultation with the Federal banking agencies . . . , *establish Federal mortgage broker requirements under this section that meet the requirements established in section 501(b)(1)*. (Emphasis added.)

**Sec. 502.**

<sup>16</sup>Section 501(b)(2)(A).

- Non-profit **budget or debt counseling services**<sup>17</sup> are exempted altogether, although to the extent these entities are engaging in mortgage brokering services there is no reason they should not be covered.
- **Consumer reporting agencies** which are in substantial compliance with the Fair Credit Reporting Act are also exempted.<sup>18</sup> This is a status exemption which provides a blanket protection to these entities once they are in compliance with a law which has nothing whatsoever to do with the regulation of mortgage brokers. Just because a CRA is in compliance with one law, does not necessarily mean that they should not be required to comply with the requirements of another law.
- **Any one who makes, services, buys or sells mortgage loans and has been approved by HUD** is also exempted.<sup>19</sup> This is despite the fact that some of the worst abuses by mortgage brokers have been caused by FHA approved mortgage brokers.<sup>20</sup>
- *Any* broker approved by **Fannie Mae**<sup>21</sup> and **Freddie Mac**<sup>22</sup> or the **Veterans Administration**<sup>23</sup> is exempted.

It is hard to imagine any mortgage broker who would *not* be covered by these exemptions. Indeed, I don't believe that a single mortgage broker that I have sued on behalf of my low income clients in the past 36 years would not be exempted from Title V through one or more of these broad exemptions.

**No Meaningful Protections.** Even for those very few mortgage brokers who might be covered (and they would have to be truly bad at their jobs to be unable to squeeze into one of the bill's broad exemptions) there are no meaningful limitations on activities. The uniform state law requirements – which are identical to those for the federal law – have only two parts: one on licensing and one establishing a national database.

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<sup>17</sup>Section 501(b)(2)(B).

<sup>18</sup>Section 501(b)(2)(C).

<sup>19</sup>Section 501(b)(2)(F)(iii)(I).

<sup>20</sup>*See, e.g.* Lew Sichelman, HUD Acts to End Flipping, Realty Times, May 7, 2003, [http://realtytimes.com/rtcpages/20030507\\_flipping2.htm](http://realtytimes.com/rtcpages/20030507_flipping2.htm).

<sup>21</sup>Section 501(b)(2)(F).(iii)(II).

<sup>22</sup>Section 501(b)(2)(F).(iii)(III).

<sup>23</sup>Section 501(b)(2)(F).(iii)(IV)

**Licensing Requirements.** A licensing requirement is a useful *first step* in the regulation of mortgage brokers, but only if there are some real requirements to obtain the license, including the posting of a realistic bond. A recent story in *The Columbus Dispatch* details the significant problems caused the state of Ohio by mortgage brokers covered by a state licensing system designed to protect the brokers, rather than the general public making Ohio the state with the highest rate of foreclosures.<sup>24</sup> Like Ohio’s mortgage broker licensing law, Title V of H.R. 1295 has no standards for license revocation, no requirements for full disclosure of complaints about brokers to consumers, no prohibitions against licensing brokers with a criminal record, and no substantive prohibitions or consumer protections in Title V.

**Mortgage Broker Database.** Title V also establishes a national database of mortgage brokers.<sup>25</sup> This database would include a listing of each person licensed under state or federal law – which would be very few of the mortgage brokers actually brokering mortgages to the general public. However, even for those brokers which would be listed in the database, there seem to be no real protections for consumers. Indeed, the only state laws which are specifically *preserved* in Title V are those providing privacy or confidentiality to the mortgage brokers who are listed in the database.<sup>26</sup> State and federal laws regarding access to public information are specifically preempted.<sup>27</sup>

There is not even an explicit requirement in this section of the bill that complaints regarding mortgage brokers listed in the database be made available to the general public. Finally, seemingly to ensure that no damaging information about mortgage brokers reach the ears of homeowners who might be potential customers (or victims), H.R. 1295 would make it a *federal crime* for someone to “willfully disclose to any person any information concerning . . . a mortgage broker.”<sup>28</sup> There is no mirror requirement applicable to mortgage brokers who might strip equity or cause a foreclosure. In fact, the only civil or criminal penalties in the title are placed there to *protect mortgage brokers*, not homeowners.

## Answers to Questions Posed by Chairman Ney

1. *Explain the differences between “licensing” and “registry.” What are the relative merits of each?*

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<sup>24</sup>Geoff Dutton, *Ohio’s Disgrace: No. 1 in Home Foreclosures*, *The Columbus Dispatch*, September 18, 2005.

<sup>25</sup> Section 512, H.R. 1295.

<sup>26</sup> Section 514(a)(1), H.R. 1295.

<sup>27</sup> Section 514(a)(2), H.R. 1295.

<sup>28</sup>Section 515(b).



Licensing suggests that the licensee has met some minimal requirements as a condition of obtaining the license. While a registry is simply a listing of participants. Both a licensing regime and a registry are meaningless, a waste of government resources, and potentially *misleading to the public*, if they do not cover all persons who are engaged in the business of brokering loans for homeowners. A license “issued by the federal government” can be used to legitimize misconduct if not accompanied by substantive regulation and enforcement.

2. *Should there be uniform standards for state licensing of mortgage brokers?*

A uniform standard is only helpful if the standards are meaningful and substantive. Uniformity should not be the excuse for minimalist. H.R. 1295's standards are so un-protective of homeowners as to be completely useless to consumers. The only purpose appears to be to protect mortgage brokers from the more stringent requirements imposed by various state laws.

3. *Explain the differences between loan originators and mortgage brokers. Should licensing and/or registry be required of both?*

The term “loan originators” implies that they are arranging loans between themselves, or their employer, and the borrower. Brokers generally arrange loans for borrowers from many different lenders. Brokers hold themselves out as acting for the borrower, searching for the best deal, providing a service to the borrower of looking for the right loan fit. This is very different from the implicit message from a loan originator who is generally only working through the arrangements of a credit relationship between one lender and the borrower. Because many consumers are led to believe that the broker is acting for them, on their behalf, to assist them, the dynamics of these relationships are different, and potentially more dangerous. It is this difference in dynamics and implicit messages that would justify a different standard and degree of regulation between mortgage brokers and loan originators.

4. *Should there be uniform standards for state education requirements (including continuing education requirements) for mortgage brokers?*

I have no opinion on this question.

5. *Should a uniform standard be a minimum standard, or a preemptive standard, i.e. should the standard be implemented as a “floor” or a “ceiling?”*

If there is a uniform standard, it should be a minimum standard, a floor, not a ceiling. Housing and lending issues are different in different states, and these differences dictate different responses. There is no reason, other than convenience of the mortgage brokers, to establish a preemptive standard, above which the states cannot go to protect their resident homeowners.

6. *Explain the benefits and/or problems associated with multi-state licensing and registration requirements.*

I have no information on this.

7. *What are the benefits of a national registry of licensed mortgage brokers and/or other loan originators?*

Unless all – or at least, most – mortgage brokers are covered by the registry, and there meaningful standards applied to the licensing requirements, there are no benefits. However, if the licensing requirements applied to all mortgage brokers, and complaints – and resolutions of those complaints – were transparent to both the general public and potential customers of the members of the registry, such a database could prove useful in providing some educational service to prevent ongoing mortgage broker abuses.

8. *Explain how a registry could be implemented and managed.*

I have no information on this.

9. *Who should be required to participate in a registry?*

Everyone who brokers more than one mortgage loan a year in the United States.

10. *What impact will registration and licensing requirements have on curbing the proliferation of predatory lending?*

If Title V of H.R. 1295 passes, predatory lending will worsen and more foreclosures will result.

11. *What are the costs associated with registration and licensing requirements? What will the impact of those costs be on consumers, brokers and mortgage companies? Do the costs outweigh the benefits?*

I have no information on this.

## **Conclusion.**

Homeowners in West Virginia and throughout the United States need strong, clear prohibitions on abusive and unfair activities by all mortgage originators. A federal law which is worthwhile would *begin* with the limitations imposed on brokers by West Virginia and other states and include real limits on fees, deceptive and unfair practices, loan terms designed to speed refinancing and trigger foreclosures. I urge you to consider substantive, meaningful provisions like these to regulate the mortgage industry and stem the tide of predatory lending and increasing numbers of foreclosures. I would be happy to provide further information to you.