HB 363

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE
Revised

House Bill 363 (The Speaker, *et al.*) (By Request – Administration)

Economic Matters Finance

Credit Regulation - Mortgage Lending and Other Extensions of Credit

This Administration bill makes a number of substantive changes to the law governing mortgage lending. The bill • prohibits lenders from charging prepayment penalties for mortgages; • requires lenders to verify a borrower's ability to repay a loan; • authorizes the Commissioner of Financial Regulation to set mortgage lender licensing fees and examination requirements; and • expands the licensing requirements for mortgage lenders and mortgage originators.

The bill takes effect June 1, 2008, but certain provisions take effect January 1, 2009.

Fiscal Summary

State Effect: Special fund expenditures could increase by approximately $668,800 in FY 2009, due to an anticipated need for additional staff to assist the Commissioner of Financial Regulation with implementation of the bill. Future year expenditure estimates reflect annualization and inflation. If the Attorney General's Office receives fewer than 50 complaints per year stemming from the bill, the additional workload could be handled with existing resources. No immediate effect on revenues.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
SF Revenue	-	-	-	-	-
SF Expenditure	668,800	722,600	757,300	793,800	832,300
Net Effect	($668,800)	($722,600)	($757,300)	($793,800)	($832,300)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary:

Prepayment Penalties: The bill prohibits lenders from requiring or authorizing the imposition of penalties, fees, premiums, or other charges for a mortgage loan in the event that the loan is prepaid in whole or in part. This does not include reverse mortgage loans. The bill raises the maximum amount of a commercial loan that may be assessed a prepayment charge or penalty on a prepayment of the unpaid principle balance from $5,000 to $15,000. In addition, the bill prohibits credit grantors from imposing a prepayment charge on the prepayment of any loan by a consumer borrower.

Lender Requirements: The bill modifies the factors that a lender or credit grantor must consider by law when making various types of mortgage loans, including both primary and secondary mortgage loans. The bill requires a lender to give due regard to the borrower's ability to repay a loan in accordance with its terms, including the fully indexed rate of the loan, if applicable, as well as property taxes and homeowner's insurance – regardless of whether an escrow account is established for the collection and payment of these expenses. Such due regard is required to include: (1) consideration of the borrower's debt to income ratio; and (2) verification of the borrower's gross monthly income and assets by review of third-party documentation, including W-2 forms, income tax returns, payroll receipts, records of a financial institution, or other third-party documents that provide reasonably reliable evidence of the borrower's income or assets. The income and asset verification requirements do not apply to mortgage loans approved for government guaranty by the Federal Housing Administration, Veterans Administration, or Community Development Administration.

Commissioner of Financial Regulation: The bill authorizes the commissioner to participate in the establishment and implementation of a multistate automated licensing system for mortgage lenders and mortgage originators. The bill also authorizes the commissioner to adopt regulations that waive or modify licensing requirements in order to facilitate implementation of the multistate system.

The commissioner is required to conduct studies on: (1) the feasibility of conducting examinations of mortgage lender licensees using a risk-based approach rather than a fixed schedule approach; and (2) the use of a call feature in loans that accelerate the indebtedness of a mortgage loan. Both reports are due by January 1, 2009 to the Senate Finance committee and the House Economic Matters Committee.

Mortgage Lender Licensing: The bill adds to the statutorily required qualifications necessary to obtain a mortgage lender's license from the commissioner. The bill requires an applicant for a mortgage broker license or current licensee to maintain a minimum net worth ranging from • $25,000 for an applicant or licensee that does not lend money; to • $250,000 for an applicant or licensee that has lent more than $10 million in the 12 months prior to the application or renewal. However, lenders that have lent more than $10 million only have to comply with a $100,000 net worth requirement until January 1, 2009, when the $250,000 requirement takes effect. Verification of net worth is required, and a line of credit may only be used to satisfy up to 75% of the minimum net worth requirement.

The bill requires the commissioner to deny an application for a license filed by • an individual who has been convicted within the last 10 years of a felony involving fraud, theft, or forgery; or • an entity that has a director, officer, partner, member, or owner of at least 10% of the entity who has been convicted within the last 10 years of a felony involving fraud, theft, or forgery. The bill staggers licensure such that a license expires two years after issuance and may be renewed for an additional two-year period at least 30 days before its expiration.

The bill authorizes the commissioner to set several of the fee amounts associated with mortgage lender licenses. These fees include • the nonrefundable investigation fee; • the license fee; • the license renewal fee; and a • per-day fee for each of the commissioner's employees engaged in examination of the business of a licensee or any other examination or investigation that the commissioner reasonably considers necessary.

The bill raises the amount of the surety bond required of applicants for both new mortgage lender licenses as well as license renewals. This bond requirement is based on an aggregate principal amount of all mortgage loans secured by property located in Maryland that were applied for, procured, and accepted by the lender during the 12 months prior to the month of the license application. The bill requires a bond of • $50,000 for an aggregate principal amount of $3 million or less; • $100,000 for an amount greater than $3 million but not exceeding $10 million; or • $150,000 for amounts greater than $10 million. The bill also raises the amount required from a lender for a blanket surety bond that covers five or more simultaneous office license applications. The new blanket surety bond amount under the bill is $750,000.

Mortgage Originator Licensing: The bill authorizes the commissioner to promulgate regulations defining the written test required of mortgage originator license applicants. In addition, the bill requires that the commissioner deny an application for a license filed by an individual who has been convicted within the last 10 years of a felony involving fraud, theft, or forgery. The bill authorizes the commissioner to set the fee amounts associated with mortgage originator licenses, including the nonrefundable investigation fee, the license fee, and the license renewal fee. The bill requires that these fees be reasonable and set in a manner that will produce funds sufficient to cover the actual direct and indirect costs of regulating mortgage originator licensees. Under the bill, the commissioner must also publish the fee schedule. The bill requires that a license be revoked if the commissioner determines that the licensee has been convicted of a felony involving fraud, theft, or forgery while licensed. The bill specifies that current fees relating to the licensing, examination, and investigation of mortgage lenders and mortgage originators will remain in effect until the fees set by regulation take effect.

Current Law: For a noncommercial loan that is secured by a mortgage or deed of trust on the borrower's primary residence, except to the extent expressly provided otherwise in the loan contract, a borrower may prepay all or part of the outstanding balance under the loan at any time. In the event that the entire loan is prepaid, the lender must refund or credit the borrower with the unearned portion of the precomputed interest charge.

If specified in a loan contract, a prepayment charge or penalty on the prepayment of the unpaid principal balance of the loan is not interest under the State's usury laws if the loan is secured by • a home; • a combination of home and business property; or • agricultural property. A prepayment charge may also be imposed on certain commercial loans of $5,000 or less. Prepayment penalties may only be imposed on prepayments made within three years from the date the loan is made and may not exceed an amount equal to two month's advance interest on the aggregate amount of all prepayments made in any 12-month period in excess of one third of the amount of the original loan.

The Federal National Mortgage Association's current first mortgage loan size limits for a single-family dwelling are • $417,000 for one-family loans; • $533,850 for two-family loans; • $645,300 for three-family loans; and • $801,950 for four-family loans. The limit for second mortgages is $208,500.

Mortgage lenders are prohibited by statute from making "covered loans" without giving due regard to the borrower's ability to repay the loan in accordance with its terms. A "covered loan" is defined as a mortgage loan that meets the criteria for a loan subject to the federal Home Ownership Equity Protection Act, with modified percentages. An exemption from this requirement exists when the borrower's monthly gross income is greater than 120% of the median family income for the metropolitan statistical area in which the residential real property securing the loan is located. Borrowers are presumed to be able to repay a loan if, at the time the loan is made, the borrower's monthly payment obligations including the required loan payment do not exceed 45% of the borrower's monthly income.

Mortgage lender license applicants must complete 40 hours of classroom education and achieve a passing grade on a written examination developed and administered by the person conducting the classroom course approved by the commissioner. The current licensing fees for mortgage lenders and brokers include a $100 investigation fee and a $1,000 license fee for a two-year license. Examinations of mortgage lenders conducted by the commissioner are currently billed at $250 per examiner per day. The required surety bond amounts are currently • $25,000 for an aggregate principal amount of $3 million or less; • $50,000 for an amount greater than $3 million but not exceeding $10 million; • $75,000 for amounts greater than $10 million; and • $375,000 for a blanket surety bond.

The current fees for a mortgage originator license include a $100 investigation fee and a $300 fee for a two-year license. Mortgage originator licensees must have at least three years of experience in the mortgage lending business, or complete 40 hours of classroom education and achieve a passing grade on a written examination developed and administered by the approved classroom course educator.

Background: Under Maryland law, mortgage lenders and originators doing business in the State must be licensed with the Commissioner of Financial Regulation. Mortgage lenders and originators seeking licenses or license renewals must meet several statutory requirements for financial responsibility and general fitness. In addition, lenders must file a surety bond, pay an investigation fee, submit to an investigation by the commissioner, and, if approved, pay the licensing fee. Both types of licensees must also meet continuing education requirements and are subject to regulation, investigation, and discipline by the commissioner, who performs these duties using the Mortgage Special Fund. Failure to meet statutory or regulatory requirements can result in license revocation.

In January of 2008, seven states joined the National Licensing System developed jointly by the American Association of Residential Mortgage Regulators and the Conference of State Bank Supervisors. A majority of states have indicated that they intend to join this system that was created to standardize the licensing and testing of mortgage professionals.

The commissioner reports that as of December 2007, there were 5,763 mortgage lenders and 11,003 mortgage originators licensed in Maryland and that the number of applications continues to increase each year. According to the commissioner, there were • 1,833 applications in fiscal 2005; • 2,191 in fiscal 2006; • 12,289 in fiscal 2007; and • 2,431 in the first half of fiscal 2008. The large number of applications in fiscal 2007 consisted of 10,200 new applications for mortgage originator licenses following creation of the originator licensing requirement. Ongoing license renewals are projected to number approximately 10,000 per year. The commissioner advises that new applications require a substantial amount of time for review due to the many factors that must be considered including • financial statements; • criminal background checks; • credit reports; • experience and continuing education requirements; • corporate documentation; and • other statutory prerequisites. Currently, the commissioner employs 19 financial examiners.

By all accounts, recent changes in the real estate market and the economy in general have led to a marked increase in foreclosure events both nationwide and in Maryland. Many such foreclosures have involved residential properties that have been financed through sub-prime loans and nonbank loan originators, leading to heightened concern regarding the lending practices that surround these nontraditional financing methods. Opinions differ regarding the exact number of recent foreclosures in Maryland, as well as the severity of the situation, but all sources report a substantial recent increase in foreclosure activity in the State.

In June 2007, the Governor established the Homeownership Preservation Task Force to develop an action plan to address rising foreclosures and preserve homeownership in Maryland. In November 2007, the task force reported that the total of all foreclosure events in the State during the second quarter of 2007 numbered 4,092, an increase of 344% when compared to the 920 events in the second quarter of 2006. According to the National Delinquency Survey from the Mortgage Banker's Association, in the second quarter of 2007, 4.19% of all mortgage loans for one-to-four unit residential properties reported serviced in Maryland were past due. Furthermore, 1.46% of all loans for similar properties during this period were seriously delinquent, meaning 90 days or more delinquent or in the process of foreclosure. This is an increase from 3.26% past due and 0.96% seriously delinquent in the second quarter of 2006.

The Legal and Regulatory Reform Workgroup of the task force reviewed existing laws, regulations, and practices relating to mortgage lending and foreclosures and developed recommendations to promote homeownership. The bill reflects several recommendations of the task force. The Attorney General also formed a workgroup to provide input on issues relating to lending practices in Maryland. In addition, the Senate Finance and Judicial Proceedings committees and the House Economic Matters and Environmental Matters committees held hearings during the 2007 interim to examine various aspects of mortgage lending practices and the foreclosure process.

State Revenues: The bill would have little immediate effect on State revenues; however, the bill authorizes the commissioner to establish licensing and examination fees by regulation. These fees would represent revenues for the Mortgage Special Fund. The commissioner advises that fees would be set by regulation in fiscal 2009 but could not provide any information on the amount of any increases.

State Expenditures: Mortgage Special Fund expenditures could increase by an estimated $668,819 in fiscal 2009, which accounts for the bill's June 1, 2008 effective date and a 90-day start-up delay. This estimate reflects the cost of hiring 12 additional financial examiners to assist the commissioner with implementation of the bill's licensing and investigation provisions. The estimate is based on the • rapidly increasing number of applications for mortgage professional licenses; • ongoing renewals of existing licenses; and • the numerous additional licensing requirements created by the bill. This estimate includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. The Department of Labor, Licensing, and Regulation reports that the Mortgage Special Fund balance as of December 2007 was approximately $6.4 million.

Positions	12
Salaries and Fringe Benefits	$528,299
Operating Expenses	140,520
Total FY 2009 State Expenditures	$668,819

Future year expenditures reflect • full salaries with 4.4% annual increases and 3% employee turnover; and • 2% annual increases in ongoing operating expenses.

Additional Information

Prior Introductions: None.

Cross File: SB 270 (The President, *et al.*) (By Request – Administration) – Finance.

Information Source(s): Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Office of the Attorney General (Consumer Protection Division); Department of Legislative Services

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