

HOUSE BILL REPORT

EHB 2340

As Passed Legislature

Title: An act relating to mortgage brokers and loan originators.

Brief Description: Regulating mortgage brokers and loan originators.

Sponsors: By Representatives Kirby, Roach, Chase, Kenney and Simpson; by request of Department of Financial Institutions.

Brief History:

Committee Activity:

Financial Institutions & Insurance: 1/12/06 [DP];
Appropriations: 1/24/06, 1/25/06 [DP].

Floor Activity:

Passed House: 2/11/06, 89-6.
Passed Senate: 2/28/06, 48-0.
Passed Legislature.

Brief Summary of Engrossed Bill

- Requires the annual expiration of mortgage broker licenses and creates a renewal process.
- Expands the time-frame during which the Director of the Department of Financial Institutions (Director) may conduct a compliance examination of mortgage broker licensees.
- Requires licensing of loan originators.
- Applies prohibited practice standards to loan originators.
- Provides the Director with various specific grants of rule-making authority.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: Do pass. Signed by 11 members: Representatives Kirby, Chair; Ericks, Vice Chair; Roach, Ranking Minority Member; Tom, Assistant Ranking Minority Member; Newhouse, O'Brien, Santos, Serben, Simpson, Strow and Williams.

Staff: Jon Hedegard (786-7127).

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: Do pass. Signed by 30 members: Representatives Sommers, Chair; Fromhold, Vice Chair; Alexander, Ranking Minority Member; Anderson, Assistant Ranking Minority Member; McDonald, Assistant Ranking Minority Member; Armstrong, Bailey, Buri, Chandler, Clements, Cody, Conway, Darneille, Dunshee, Grant, Haigh, Hinkle, Hunter, Kagi, Kenney, Kessler, McDermott, McIntire, Miloscia, Pearson, Priest, Schual-Berke, P. Sullivan, Talcott and Walsh.

Staff: Elisabeth Donner (786-7137).

Background:

Licensure of Mortgage Brokers.

In order to make a loan in Washington, mortgage brokers must be licensed. The license does not expire and is not renewed. Mortgage brokers must pay an annual fee to maintain licensure. If the fee is not paid, the Department of Financial Institutions (DFI) must initiate proceedings to revoke the license. Designated brokers of every licensee must complete continuing education requirements. Mortgage brokers are subject to prohibited practices. Requirements for mortgage brokers generally include honesty, veracity, provision of required disclosures, and compliance with appropriate state and federal laws and rules.

Loan Originator.

Loan originators are employed, retained, or represent a person required to have a mortgage broker license in the performance of specific activities relating to a residential mortgage loan. Loan originators are not licensed.

Sanctions.

The Director of the Department of Financial Institutions (Director) must enforce all laws and rules relating to the licensing of mortgage brokers. The Director may impose fines or order restitution. The Director may deny, suspend, or revoke licenses.

Compliance Examinations.

The DFI may only examine the business of a mortgage broker once in the first two years of operation as a licensee. However, there has been no funding mechanism for these examinations and therefore no functioning program has been established. The bill provides the Director with compliance examination authority during the first five years of licensure or during the first five years after the licensee opens any new branch.

Investigations.

The DFI may, at any time, investigate complaints against a licensee or any other person in the business of mortgage brokering.

Cooperation with Examinations and Investigations.

The Director or a designee may direct the production of materials relevant to the investigation or require a person to testify under oath. A subpoena may be issued if the materials are not

produced or if a person does not testify after being ordered to do so. No person may remove, withhold, or destroy requested materials.

Mortgage Brokerage Commission (Commission).

The Commission advises the Director on the characteristics and needs of the mortgage brokerage profession. The Commission consists of five members appointed by the Director. At least three members must be mortgage brokers.

Summary of Engrossed Bill:

Licensure of Mortgage Brokers

Applicant information - In addition to information currently required in an application, mortgage broker applicants must provide their fingerprints, personal history, business record, and other information required by the Director. The Director must submit the information for a state and federal criminal history background check. The Director may receive nonconviction information but may only disseminate that information to criminal justice agencies.

License expiration and renewal - Mortgage broker licenses expire annually. The Director must adopt rules for the license renewal process.

Continuing education - The Director may allow outside professional organizations to provide continuing education to designated brokers. The Director may allow for reciprocity with other states' continuing education requirements.

Prohibited practices - Added to the prohibited practices are failure to comply with specific federal laws.

Loan Originators.

Definition - The definition of loan originator is changed to include anyone who does (or is held out as able to):

- take a residential mortgage application from a broker; or
- offer or negotiate terms of a mortgage loan for direct or indirect compensation, or the expectation of compensation.

Licensing - Loan originators must be licensed. The application must include the applicant's name, date of birth, social security number, fingerprints, personal history, business record and other information required by the Director. The Director must submit information for a state and federal criminal history background check. The Director may receive nonconviction information but may only disseminate that information to criminal justice agencies.

The applicant must pay an application fee established by rule by the Director. The Director must adopt rules regarding procedures relating to incomplete applications. The Director must adopt rules regarding the content of a written examination.

The Director must issue the license if the application is complete, the applicant passed the written examination, and the fee is paid unless:

- the applicant has had a similar license revoked within seven years of the application;

- the applicant has been convicted of a gross misdemeanor regarding dishonesty or financial misconduct or felony within seven years of the application; or
- the applicant has not been able to demonstrate the character and general fitness required to warrant a belief that the business will be operated honestly and fairly.

Loan originator licenses expire and must be renewed. Loan originator licenses may not be assigned or transferred. Licensees seeking to renew their license must complete the required continuing education requirements. The continuing education requirements must be adopted by rule by the Director.

Prohibited practices - Loan originators are subject to the same prohibited practices as mortgage brokers. Loan originators may not accept any compensation from a borrower for the preparation, negotiation, and brokering of a loan. Loan originators may only take applications on behalf of one mortgage broker at a time. The mortgage broker must be clearly identified on the application.

Ability to contractually bind mortgage brokers - Contracts between a loan originator and a borrower must be in writing and contain the entire agreement. The contract is binding on the mortgage broker.

Sanctions.

The Director may enforce all laws and rules relating to the licensing of mortgage brokers and loan originators. The Director may impose fines or order restitution. The Director may deny, suspend, or revoke a license.

Compliance Examinations.

The DFI may only examine the business of a mortgage broker once in the first five years of being licensed, including the licensing of a branch. The scope of the examination is limited to compliance with the laws and rules related to mortgage brokers. The scope or time-frame may be expanded upon the clear identification of a need to do so. The Director must establish rules regarding protocols of examination findings and corrective actions. The reports must include a process for clear notification of violations to the licensee and an opportunity for the licensee to respond.

The Director may consider reports made by an independent professional that cover the same subject as the examination and incorporate all or part of the independent report into the examination report. The Director may retain attorneys, auditors, or other professionals to aid in an investigation or examination.

Investigations.

A complaint does not have to enable the DFI to investigate a licensee or any other person in the business of mortgage brokering.

Cooperation with Examinations and Investigations.

The Director or a designee may direct the production of materials relevant to the investigation or require testimony under oath of a person. A person who removes, withholds, or destroys

requested materials is guilty of a class B felony or punishable by a fine of not more than \$20,000 or both.

Mortgage Brokerage Commission (Commission).

The Commission is expanded to seven members appointed by the Director. At least two members must be loan originators.

Annual Reports by Licensees.

Annually, licensees must provide the Director with a report of mortgage broker activity. The Director may establish the format by rule. The report may only include the total number of closed loans and total dollar volume of closed loans originated by the mortgage broker in Washington. Any information that is a trade secret is exempt from public disclosure unless aggregated in a manner that the individual broker's information is not identifiable.

The Director may take the actions necessary to implement the act upon the date the act becomes effective.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on January 1, 2007.

Testimony For: (Financial Institutions & Insurance) This is a DFI request bill. The DFI has held many meetings with all stakeholders to work out issues related to this bill. In December, we learned that one group that makes up a small portion of those impacted under the bill is not in agreement on every point. The DFI met with that group on nine occasions to resolve their concerns. There were six points of contention. On two points, the DFI made changes. Three issues were misinterpretations of bill language by the group. On the last point, the DFI cannot agree. This is an important bill. The DFI examination authority is extended from two years to five years. Companies will not pay for an examination. The cost of the examinations will be paid for by the licensing fees. There is no other revenue source in the bill. Compliance examinations are intended to keep good companies in compliance with the law. Currently, mortgage brokers are the only major financial service group that is not regularly examined. The DFI will have rule-making authority in specific areas. This is customary, prudent and flexible. All of the DFI's rule-makings are negotiated. They are time-consuming, consensual, and within the granted authority. The realtors support the bill. The DFI should be commended for involving all parties. Loan originators meet with consumers more than any other group. They should be licensed. One of the best tools to prevent problems is compliance examinations. The DFI needs more authority to examine mortgage brokers. There is little state oversight today. Federal audits of loans find an overwhelming amount of problems in mortgage lending. The bill is a great step forward. Loan originators are not licensed today. This is a major regulatory gap. Over half of the states now regulate loan originators. Fraud is on the rise in mortgage lending. Minimum standards for loan originators would greatly help the fight against fraud. Loan originators should have to have a background check, meet continuing education requirements, and be subject to enforcement for violations of the law. This is a good business with some bad actors. The bill will prevent those bad

actors from doing business in Washington. The auditing and compliance aspects are very important, particularly for the branch offices. Often a branch office does not have the same internal oversight as the main office. This is a reasonable and important bill. The mortgage broker industry is asking for this additional regulation. There are problems that needed to be corrected on the front lines of mortgage transactions. There are five times as many loan originators as mortgage brokers. Consumers are more likely to interact with a loan originator than a mortgage broker. There are no background checks and no licensing standards for that loan originator. The DFI has worked with stakeholders at each step. There are issues where rules are more appropriate and flexible. Those areas should be addressed in rule, not law.

Testimony For: (Appropriations) We support the consumer protection elements, the inclusion of loan originators, and the expansion of the Director's authority for examinations. Since last March, the Department of Financial Institutions (DFI) has conducted more than 35 meetings with representatives from the industry, including realtors, appraisers, lenders, and mortgage brokers. The DFI has received support from the mortgage, appraisal, and realtor industries. They have reached out to those initially opposed, and they believe a resolution has been developed through this bill. Companies will not be paying for the cost of examinations. The costs will be absorbed through loan originator license fees. The DFI's intent is to raise only enough revenues to pay for the program. The DFI will set the correct amount of license fees by rule once they have a better idea of the actual number of loan originators. Past examples show that the mortgage broker industry has done poorly when regulation has been handed down. This legislation benefits the consumer and cleans up the fraud problems in lending. Examples were provided from other states where the demonstrated knowledge level of loan originators was lacking, indicating a need for this bill. The bill is designed not to be a burden on the state.

Testimony Against: (Financial Institutions & Insurance) None.

Testimony Against: (Appropriations) None.

Persons Testifying: (Financial Institutions & Insurance) Chuck Cross, Department of Financial Institutions; Laura Kiel, Kiel Management and Management Commission; Adam Stein, Washington Association of Mortgage Brokers; Steve Bozick, Washington Association of Mortgage Brokers; Richard Hagar, American Home Appraisals; and Bob Mitchell, Washington Realtors.

Persons Testifying: (Appropriations) Chuck Cross, Department of Financial Institutions; Adam Stein, Washington Association of Mortgage Brokers; Bob Mitchell, Washington Realtors; and Jim Irish, Appraisers' Coalition of Washington and American Society of Appraisers, Seattle Chapter.

Persons Signed In To Testify But Not Testifying: (Financial Institutions & Insurance) None.

Persons Signed In To Testify But Not Testifying: (Appropriations) None.