

# HOUSE BILL REPORT

## 2SHB 1405

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### As Passed Legislature

**Title:** An act relating to loans made under the consumer loan act.

**Brief Description:** Regulating loans made under the consumer loan act.

**Sponsors:** House Committee on General Government Appropriations & Oversight (originally sponsored by Representatives Kirby, Kelley, Ladenburg, Darneille, Ryu, Stanford and Jinkins).

#### **Brief History:**

##### **Committee Activity:**

Business & Financial Services: 1/25/11, 1/27/11, 2/4/11 [DPS];

General Government Appropriations & Oversight: 2/15/11, 2/17/11 [DP2S(w/o sub BFS)].

##### **Floor Activity:**

Passed House: 3/2/11, 96-0.

Senate Amended.

Passed Senate: 4/9/11, 47-2.

House Concurred.

Passed House: 4/14/11, 97-0.

Passed Legislature.

#### **Brief Summary of Second Substitute Bill**

- Modifies the Consumer Loan Act (CLA) exemption regarding loans made primarily for business, commercial, or agricultural purposes to except loans that are secured by a lien on the borrower's primary residence.
- Allows the Director of the Department of Financial Institutions (Director) to waive licensing CLA provisions for persons servicing loans when the Director determines it necessary to facilitate commerce and protect consumers.
- Creates additional prohibited practices.

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### HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Kirby, Chair; Kelley, Vice Chair; Bailey, Ranking Minority Member; Buys, Assistant Ranking Minority Member; Blake, Condotta, Hudgins, Hurst, Parker, Pedersen, Rivers, Ryu and Stanford.

**Staff:** Jon Hedegard (786-7127).

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## HOUSE COMMITTEE ON GENERAL GOVERNMENT APPROPRIATIONS & OVERSIGHT

**Majority Report:** The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Business & Financial Services. Signed by 12 members: Representatives Hudgins, Chair; Miloscia, Vice Chair; McCune, Ranking Minority Member; Taylor, Assistant Ranking Minority Member; Ahern, Blake, Fitzgibbon, Ladenburg, Moscoso, Pedersen, Van De Wege and Wilcox.

**Staff:** Michael Bennion (786-7118).

### **Background:**

The Consumer Loan Act (CLA) authorizes the Department of Financial Institutions (DFI) to regulate consumer loan companies doing business in Washington. Consumer loan companies include mortgage lenders and consumer finance companies.

### License Required.

No person may engage in the business of making secured or unsecured loans of money, credit, or things in action unless licensed by the DFI under the CLA or exempt from licensure. The CLA provides exemptions from licensing for:

- any person making loans primarily for business, commercial, or agricultural purposes, or making loans made to government or government agencies or instrumentalities, or to an "organization" as defined in the federal Truth in Lending Act;
- an entity licensed as a bank, savings bank, trust company, savings and loan association, building and loan association, or credit union under state or federal law;
- entities licensed as pawnbrokers;
- entities making loans for retail installment sales of goods and services;
- entities licensed as a check casher or seller;
- entities making loans under the Housing Trust Fund;
- entities making loans under programs of the federal government that provide funding or access to funding for single-family housing developments or grants to low-income individuals for the purchase or repair of single-family housing;
- nonprofit housing organizations making loans, or loans made, under housing programs that are funded by federal or state programs if the primary purpose of the programs is to assist low-income borrowers with purchasing or repairing housing or the development of housing for low-income state residents; and
- entities making loans which are not residential mortgage loans under a credit card plan.

An applicant for a license and any officers and principals of the applicant must undergo a background check. A licensee must maintain a surety bond or meet other specified financial requirements. The amount of the bond is based on the annual dollar amount of loans originated with a minimum amount of \$30,000.

#### Powers of a CLA Licensee.

A CLA licensee may:

- lend money at a rate that does not exceed 25 percent per annum;
- charge a borrower a nonrefundable, prepaid, loan origination fee limited to 4 percent of the first \$20,000 loaned and 2 percent of any amount above \$20,000. The fee may be included in the principal balance of the loan;
- agree with the borrower for the payment of fees to third parties other than the licensee who provides goods or services to the licensee in connection with the preparation of the borrower's loan and may include such fees in the amount of the loan. However, no charge may be collected unless a loan is made, except for reasonable fees properly incurred in connection with the appraisal of property by a qualified, independent, professional, third-party appraiser;
- in connection with a loan secured by real estate, agree with the borrower to pay a fee to a mortgage broker that is not owned by the licensee or under common ownership with the licensee and that performed services in connection with the origination of the loan. A licensee may not receive compensation as a mortgage broker in connection with any loan made by the licensee;
- charge and collect a penalty of not more than 10 percent of any installment payment delinquent 10 days or more;
- collect fees and expenses related to a collection when a debt is referred to an attorney who is not a salaried employee of the licensee;
- make open-end loans as provided in the CLA;
- charge a fee for dishonored checks; and
- sell insurance covering real and personal property, covering the life or disability or both of the borrower, and covering the involuntary unemployment of the borrower.

#### Prohibited Practices.

There are a variety of prohibited practices under the CLA to ensure fair, honest, and open practices.

#### Mortgage Loans and Mortgage Loan Servicing.

In 2009 a law was enacted that regulates mortgage loan servicers under the CLA. In 2010 changes to the Escrow Act were made, including changes to the exemptions from regulation under the Escrow Act. As a result of the 2009 and 2010 legislation, a small group of people who service mortgage loans are regulated under the Escrow Act and the CLA.

The Director has the authority to waive licensing CLA provisions for persons making mortgage loans when the Director determines it is necessary to facilitate commerce and protect consumers.

#### Administrative Enforcement.

The Director of the DFI (Director) may deny applications or renewals or suspend or revoke licenses for specified actions or failures to act by an applicant or licensee. The Director may

impose fines for violations. The Director may issue an order directing the licensee, its employee or loan originator, or other person subject to the CLA to:

- cease and desist from conducting business in a manner that is injurious to the public or violates any provision of the CLA;
- take action necessary to comply with the CLA; or
- make restitution to a borrower or other person who is injured by a CLA violation.

#### Penalties.

Violations of the CLA are violations of the Consumer Protection Act (CPA). The Office of the Attorney General may bring an action on behalf of persons injured by a violation of the CPA. A private party may also bring an action to enforce the CPA. The CPA allows an injured party to receive treble damages, up to a maximum of \$25,000.

Certain violations are gross misdemeanors. A gross misdemeanor is punishable by:

- imprisonment for not more than 12 months in jail;
- a maximum fine of \$5,000; or
- a combination of imprisonment and a fine.

In 2009 the statute concerning the exemptions was amended in two different bills. The difference in language could not be reconciled by the Code Reviser. The result is two different, overlapping statutes in law.

#### **Summary of Second Substitute Bill:**

The exemption regarding loans made primarily for business, commercial, or agricultural purposes is modified to except loans that are secured by a lien on the borrower's primary residence.

It is a prohibited practice for a licensee to execute or induce the execution of an instrument that conveys any ownership interest in a borrower's primary residence to the lender. The prohibition only applies to actions that are contemporaneous to the making of the loan and are prior to a default on the loan. The prohibited practice does not apply to mortgages or deeds of trust.

It is a prohibited practice for a licensee, at the time of closing a loan, to obtain a release for damages resulting from a violation of the usury law, the CLA, or other laws.

The Director may waive licensing CLA provisions for persons servicing mortgage loans when the Director determines it is necessary to facilitate commerce and protect consumers.

Several formatting and housekeeping changes are made.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony (Business & Financial Services):**

(In support) The bill is a response to a problem that has been reported on the local press. A person is making loans and claiming that he is exempt under the CLA. That person is requiring borrowers to pledge their house as a condition of receiving the loan. The contracts are set up in such a way that the borrower will lose their house. The lender has no interest in getting the loan repaid. The purpose of the loan is to take the house away from the borrower. The bill was narrowly crafted to address this problem. The bill is intended to address the situations where homeowners are being defrauded. The transactions are purported to be business loans but are truly mortgage loans. Licensees under the CLA are regulated and support the attempt to prevent criminal behavior by bad actors. The CLA is intended to protect consumers. This is a good bill. The language of the statutes did need to be cleaned up. These language changes in the bill provide clarity. The bill addresses some important issues. Often the victims of the illegal lenders are vulnerable and unaware of their rights. Under existing law, it is not easy for the DFI to determine if they have jurisdiction without performing an investigation. The bill addresses that issue and is a very good solution to a number of serious problems.

(Opposed) None.

**Staff Summary of Public Testimony (General Government Appropriations & Oversight):**

(In support) None.

(Opposed) None.

**Persons Testifying (Business & Financial Services):** Representative Kirby, prime sponsor; Representative Kelley; Tom Echols, Washington State Financial Services Association; and David Leen.

**Persons Testifying (General Government Appropriations & Oversight):** None.

**Persons Signed In To Testify But Not Testifying (Business & Financial Services):** None.

**Persons Signed In To Testify But Not Testifying (General Government Appropriations & Oversight):** None.