The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Banking and Insurance Committee

BILL: SB 2846

INTRODUCER: Senator Deutch

SUBJECT: Subprime Loans

DATE: April 12, 2008 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	**Favorable**
2.			CM	
3.			JU	
4.			GA	
5.				
6.				

I. Summary:

The Florida Fair Lending Act, enacted in 2002, provides consumer protections for home loans by imposing restrictions and disclosures on high-cost home loans, to be enforced by the Office of Financial Regulation. The bill expands the number and type of loans subject to the provisions of the Florida Fair Lending Act by applying these provisions to subprime loans rather than high-cost loans. The bill revises the Florida Fair Lending Act by:

- Lowering the rates and fee thresholds on what is considered a subprime loan subject to the act and so that many loans originated for a purchase or refinance of a one to four family residence would be considered subprime loans.
- Adding prohibited practices for subprime loans in Florida.
- Making any violation of this act a violation under part II of ch. 501, F.S. (Florida Deceptive and Unfair Trade Practices Act).

This bill substantially amends the following sections of the Florida Statutes: 494.0078, 494.0079, 494.00791, 494.00792, 494.00794, 494.00796, and 494.00798.

II. Present Situation:

Prime loans are typically made to creditworthy borrowers. “Subprime loans,” refers to the extension of high rates, high fee loans to persons who are considered higher risk borrowers due to impaired or limited credit. The tremendous growth in subprime mortgages has enabled many consumers to obtain home loans who previously would have had much more limited access to the credit market.

However, with this increase in subprime lending, there has also been an increase in reports of abusive lending practices and fraud. The average foreclosure rate for all subprime loans during 2006-2007 was 4.35 percent nationwide, while the average prime loan foreclosure rate was 0.48 percent.[1] These predatory lending practices include loan flipping, packing, asset-based lending, and outright fraud. Loan flipping involves repeatedly refinancing loans and charging high fees each time without any benefit to the borrower. Packing refers to adding fees far exceeding those justified on economic grounds, often through loan terms, such as the financing of points, fees, and prepayment penalties, insurance, and balloon payments (payments due at the end of the loan that are significantly higher than monthly payments). Asset-based lending refers to the practice of lending based on a borrower's overall assets, rather than the ability to repay. Most of these practices are prohibited for high coast loans under the federal Home Ownership and Equity Protection Act of 1994 (HOEPA).

Federal Law: Home Ownership and Equity Protection Act of 1994 (HOEPA)
In response to concerns about abusive lending practices involving home loans with high rates or high fees, in 1994 the Congress enacted the Home Ownership and Equity Protection Act (HOEPA), which amended the Truth in Lending Act. HOEPA seeks to protect homeowners from loan agreements that are likely to result in default and the loss of their homes by requiring additional disclosures and prohibiting certain loan terms, such as balloon payments for short-term loans and non-amortizing payment schedules, and restricting prepayment penalties. The act applies to home mortgage loans, but does *not* cover loans to purchase homes. That is, home-closed end equity loans and refinancing are covered, but not the original mortgage loan to purchase the home.

Interest rate or fee trigger for covered loans - HOEPA does not limit the interest rate or points that a lender may charge, but sets triggers based on a loan's interest rate or its points and fees to determine whether a loan is a "high cost" loan that is covered under the act. The Board of Governors of the Federal Reserve System is authorized to adjust these triggers within specified limits and, for all mortgage loans, to prohibit acts or practices that are unfair, deceptive, or designed to evade HOEPA. A high cost loan covered by HOPEA, for a *first* mortgage lien, has an *interest rate 8 percentage points above comparable Treasury securities*. For *second* liens mortgages, the trigger is *10 percentage points above Treasury securities*.

Under the fee based trigger, a loan is covered by HOEPA if the total points and fees exceed 8 percent of the loan amount or $561, whichever is greater, adjusted annually based on the Consumer Price Index since 1994. Credit insurance premiums for insurance written in connection with the credit transaction are counted as fees.

Required disclosures - Lenders offering high-cost loans that exceed the trigger must give consumers an abbreviated disclosure statement at least 3 business days before the loan is closed. These disclosures inform consumers that they are not obligated to complete the transaction and could lose their home if they take the loan and fail to make payments. It also provides the cost of credit as an annual percentage rate (APR). The federal regulations enhanced the disclosures to alert consumers to the total amount borrowed, which may be substantially higher than the loan

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[1] Congressional Research Service, Understanding Mortgage Foreclosure: Recent Events, the Process, and Costs, November 7, 2007.

amount requested by the borrower due to the financing of insurance, points, and fees. The disclosure must specify whether the total amount borrowed includes the cost of optional insurance.

Prohibited loan terms - HOEPA restricts certain loan terms for high cost loans. Prepayment penalties after 5 years are prohibited, but allowed within the 5 five years under certain conditions. In addition, balloon payments are prohibited in high cost loans that have a term of less than 5 years, with exceptions. The act also prohibits negative amortization payment schedules (which involve small monthly payments that cause an increase in the total debt), and higher interest rates upon default.

Consideration of Consumer's Ability to Repay - HOEPA prohibits lenders from engaging in a pattern or practice of extending credit to consumers based on the consumers' collateral without regard to the consumers' ability to repay the loans. The rules strengthened these provisions by creating a presumption that a lender has violated this statutory prohibition, if the lenders generally does not verify and document consumers' repayment ability.

Loan Flipping - The federal regulation address "loan flipping" within the first 12 months of a HOEPA high cost loan. A lenders that has made a HOEPA loan to a borrower in the preceding 12 months is generally prohibited from refinancing another HOEPA loan to the same borrower unless the loan is "in the borrower's interest."

Open-end loans - The federal regulation attempts to prevent evasions of HOEPA, which only covers closed-end loans, by prohibiting a lender from wrongfully documenting them as open-end credit. For example, a high cost mortgage could not be structured as a home-secured line of credit if there is not reasonable expectation that repeat transactions will occur under a reusable line of credit.

Due-on-Demand - To ensure that lenders do not accelerate the payment of HOEPA loans without cause, the rules prohibit a creditor from exercising "due-on-demand" or "call" provisions in a HOEPA loan, unless the clause is exercised in connection with the consumer's default.

Other Federal Lending Laws

In addition to HOEPA, the Congress has enacted many acts designed to provide standards and practices for extending credit to consumers for the purchase of residences and other consumer goods. Some acts include the Truth in Lending Act (TILA), which HOEPA amended, the Home Mortgage Disclosure Act (HMDA), the Real Estate Settlement Procedures Act (RESPA), the Fair Housing Act (FHA), and the Equal Credit Opportunity Act (ECOA).

The TILA requires creditors to disclose credit terms and the cost of consumer credit as an annual percentage rate. The act requires additional disclosures for loans secured by a consumer's home, and permits consumers to cancel certain transactions that involve their principal dwelling.

The HMDA, first enacted in 1975, requires lending institutions to report public loan data to assist the public and government agencies: in determining whether financial institutions are serving the needs of their communities, in distributing public dollars so as to attract private investment in underserved areas, and in identifying possible discriminatory lending patterns.

The RESPA was enacted in 1974 to provide consumers with disclosure about closing costs and to prohibit unearned fees (kickbacks/referral fees). The act requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process. The act applies to all federally related mortgage loans, which includes refinances, secured by a first or subordinate lien on residential real property.

The FHA was passed as part of the Civil Rights Act of 1968, and prohibits the refusal to sell, rent, or negotiate for the sale or rental of housing for reason of race, color, religion, sex, handicap, familial status (if a household includes children), and national origin. The ECOA prohibits discrimination in all personal and commercial credit transactions based on race, color, religion, national origin, sex, marital status, age, and other bases. The ECOA is broader than the FHA since the ECOA covers virtually all lenders while the FHA covers only real estate-related lending. Housing lenders are subject to both statutes.

Florida Laws Regulating Lenders and Mortgage Transactions

The Florida Office of Financial Regulation is responsible for regulating entities that provide financial services, such as, state-chartered financial institutions (ch. 655, 657, 660,667, F.S.), and those licensed entities engaging in mortgage brokerage and mortgage lending activities (ch. 494, F.S.).

In addition, Florida law provides guidelines for Instruments Deemed Mortgages and the Nature of Mortgages (ch. 697, F.S.), and provides protection for the consuming public and legitimate business enterprises from those who engage in unfair methods of competition, or unconscionable, deceptive, or unfair acts or practices in the conduct of any trade or commerce (Chapter 501, F.S. – the “Little FTC” Act).

Mortgage brokers and lenders and state-chartered financial institutions must comply with federal regulations as well as state laws regulating the industry. Mortgage brokers and lenders must be licensed to operate in the state and must follow federal guidelines for lending. For instance, banks, credit unions, and mortgage companies must comply with Regulation C of the Home Mortgage Disclosure Act of 1975, providing citizens and public officials with data to help determine whether lenders are meeting the credit needs of their communities and complying with fair lending laws. In addition, Regulation Z, which implements the Truth in Lending Act, applies to all persons who extend consumer credit secured by real estate, more than 5 times a year.

In 2007, the Florida Legislature enacted legislation that provided additional consumer protections related to the mortgage loan process and enforcement authority for the office.[2] The bill:

- Requires mortgage brokers and lenders offering adjustable rate mortgages to provide borrowers with a copy of the *Consumer Handbook on Adjustable-Rate Mortgages*,[3] which explains the different loan products and the potential risks associated with these products.

[2] Chapter 20007-182, L.O.F.

[3] Published by the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision.

- Requires that brokers disclose to borrowers the amount of payment that the brokers will receive from lenders no later than three business days after brokers become aware of the exact amount, and no later than three business days prior to closing.
- Requires borrowers to be notified of any material changes to the terms of a previously offered loan within three days of being made aware of the change and no later than three business days before closing. The licensee bears the burden of proving that the notice was provided and that the borrower accepted the new terms.
- Authorizes the OFR to pursue an enforcement action against mortgage brokers and mortgage lenders who violate the federal Real Estate Settlement Procedures Act (RESPA) or the federal Truth-in-Lending Act.
- Authorizes the OFR to take action against the principal representative of a lender based on the actions of the lender's associates or employees.
- Authorizes the OFR to impose an administrative fine of up to $5,000 for each separate violation of Part I, ch. 494, F.S.

Florida Fair Lending Act

The Florida Fair Lending Act, enacted in 2002, imposes restrictions on high-cost home loans, to be enforced by the Office of Financial Regulation.[4] The act imposes requirements on high cost mortgage loans that mirror the requirements of the federal Home Ownership and Equity Protection Act (HOEPA), but adds other restrictions and enforcement provisions. These requirements apply to high cost mortgage loans that charge interest or points that exceed the same triggers as provided in HOEPA. These requirements apply to closed-end loans made to refinance existing mortgages and closed-end home equity loans that include terms that meet certain criteria. The act does not cover mortgage loans to buy or build a home, reverse mortgages, and open-end, home equity lines of credit. The act covers first and subordinate mortgage loans used to refinance mortgages on a consumer's primary residence that exceed certain interest rate and fee thresholds.

Definition of "High-Cost Home Loan"

The definition of "high-cost home loan" is the same as in the federal (HOEPA) law. The *interest rate trigger*, for a first mortgage lien, is 8 percentage points above U.S. Treasury Securities of comparable maturity. For second and subordinate lien mortgages, the interest rate is 10 percentage points above U.S. Treasury Securities. The *fee-based trigger* is reached if total points and fees exceed the greater of 8 percent of the loan amount or $480 for 2002, adjusted annually based on the Consumer Price Index, currently $561. Fannie Mae and Freddie Mac loans are exempt from the act.

Prohibited Provisions for High-Cost Home Loans

A high-cost home mortgage loan is permitted, but the following loan provisions and practices are prohibited for high-cost home loans:

- Prepayment penalties are prohibited after the first 36 months of the loan; prepayment penalties during the first 36 months are permitted under certain conditions.
- The interest rate may not be increased after default.

[4] Chapter 2002-57, L.O.F.

- Balloon payments are prohibited for loans of less than 10 years, except for bridge loans of less than 18 months.
- Negative amortization schedules are prohibited, where interest payments do not reduce the principal.
- No more than two payments may be consolidated and paid in advance from the loan proceeds.
- A lender may not engage in a pattern or practice of making high-cost home loans based upon the collateral without regard to the borrower's ability to repay the loan.
- Payments under home improvement contracts may not be made directly to the contractor.
- The lender may not call or accelerate the indebtedness, except for the borrower's failure to abide by the terms of the loan, or fraud or material misrepresentation by the consumer.
- Refinancing within the first 18 months is prohibited, unless the new loan has a reasonable benefit to the borrower considering all of the circumstances.
- A lender may not make an open-ended loan in order to evade the provisions of this act.
- A lender may not make a loan at the residence of the borrower, without an appointment or express invitation.
- A lender may not charge a late payment fee unless the payment is at least 15 days late and the fee may not exceed 5 percent of the amount due.
- A lender may not charge a borrower any fees to defer payment or to modify the loan, for a minimum of one deferral or modification per each 12 months of the length of the loan.

Required Disclosures for High-Cost Home Loans

Lenders must provide certain disclosures to the borrower at least 72 hours before the closing of a high-cost home loan, including notice that the borrower should consider consulting a qualified independent credit counselor, and that the borrower should contact the U.S. Department of Housing and Urban Development for a list of credit counselors available in the area. Other disclosures (among others) inform the borrower that the borrower could lose their home if they do not meet their obligations; that the borrower should shop around and compare loan rates and fees; that the mortgage is subject to the Florida Fair Lending Act and purchasers and assignees of the mortgage could be liable for all claims and defenses which the borrower can assert against the lender; and that the borrower has the right to rescind the loan within 3 business days.

Any person who purchases or is assigned a high-cost home loan shall be subject to all claims and defenses that the borrower could assert against the lender of the mortgage, to the same extent and limitations as provided in the federal HOEPA law (15 U.S.C. 1641).

III. Effect of Proposed Changes:

Currently, the Florida Fair Lending Act addresses "high-cost home loans," and provides disclosures and restrictions for such loans. Under the bill, the Florida Fair Lending Act would apply to "subprime home loans," rather than "high-cost" loans." The term "high-cost home loan" is deleted, and new definitions for the terms "home loan" and "subprime loan" are added to the act.

The bill defines a "home loan" as a loan, including an open-end credit plan, other than a reverse mortgage transaction, in which the 1) the debt is incurred primarily for personal, family, or household purposes; and 2) the loan is secured by either a security interest on a manufactured home or a mortgage deed of trust on real estate in this state. The term is limited to owner-occupied dwellings and dwellings principally for occupancy by one to four families.

The bill lowers the thresholds under the Fair Lending Act, for purposes of a high cost loan to now what is considered a "subprime loan" to include:

- First mortgage adjustable rate loans where the fully indexed rate (APR) is in excess of 3 percent above the weekly average yield of U. S. Treasury Securities of similar maturity. Current law sets the trigger at 8 percent above 20-year Treasury securities.
- First mortgage fixed rate loans where the annual percentage rate (APR) is in excess of 5 percent above the weekly average yield of U.S. Treasury Securities of similar maturity. Current law sets the trigger at 8 percent above the 20-year Treasury securities.
- Subordinate lien mortgage loans where the APR is greater than 7 percent above the weekly average yield of U. S. Treasury Securities of similar maturity. Current law set sets the trigger at 10 percent above 20 year Treasury securities.
- Total points and fees paid by the borrower, excluding bona fide discount points, exceed 3 percent of a loan amount of $30,000 or more. Current law sets the trigger at the larger of $561 or 8 percent of the loan amount. If the loan amount is less than $30,000, the total points and fees on the loan, excluding up to two discount points paid by the borrower at or before closing, exceed the lesser of $900 or 6 percent of the loan amount. Current law does not distinguish between the amount of the loan in setting the fee trigger.

Due to the lower rate and fee thresholds provided in the bill, more loans originated for the purpose of a purchase or refinance of a one to four family residence potentially would be considered subprime loans. Under the current law, many of these loans would not be subject to the Florida Fair Lending Act, due to the higher rate and fee thresholds.

Table funded transactions (closed in the broker's name, however funds come from other source) are considered as broker transactions under the act and any fees generated as part of the transaction, including fees received when assigning the loan to the person actually funding the loan are considered in determining whether the loan is considered a subprime loan.

Under the bill, in order to determine whether a loan is a subprime loan and subject to the bill's provisions, the following charges would be included in the calculation of the points and fees:

- Mortgage broker fees.
- Lender paid compensation (yield spread premiums).
- Lender fees received – directly or to affiliated parties.
- The costs of all premiums financed by the lender directly or indirectly.
- Maximum amount of any prepayment penalty that may be charged.

The current Florida Fair Lending Act contains numerous prohibited practices. The bill provides the following prohibited practices for subprime loans:

- Prepayment penalties. Prepayment penalties are allowed under current law, up to the first 36 months of the loan, if certain conditions are met.
- Increased interest rate upon default. This is prohibited under current law.
- Balloon payments during life of loan. The current law provides an exception to this prohibition.
- Negative amortization loans. This is prohibited under current law.
- Extension of credit without regard to the payment ability of the borrower (based on fully indexed interest rate on adjustable rate loans).
- Lack of verification of the borrower's income and financial resources. The current law prohibits a lender from engaging in any pattern or practice of extending high cost loans to borrowers based upon the borrowers' collateral without regard to the ability to repay the loan, including current and expected income, obligations, and employment.
- Refinancing of subprime loans to same borrower without reasonable financial benefit to the borrower. Current law has a similar provision, in substance.
- Payments to home improvement contractors until the work have been completed. Current law prohibits payments to home improvement contractors, with certain exceptions which may, in effect, be similar.
- Mandatory arbitration clauses. Current law does not provide such a prohibition.
- Charge fees for payoff information. Current law does not have this prohibition.
- Modification of deferral fees. Current law allows an exception to this prohibition.
- Financing any credit life, credit liability, etc. types of insurance. This is not prohibited under current law.
- Financing any of the fees charged as part of the loan. This is not prohibited under current law.
- Mortgage broker and/or lender collecting any points or fees when refinancing a subprime loan into another subprime loan with the same lender. Current law does not prohibit this.

Prior to making an adjustable rate loan, the lender must disclose to the borrower the terms and conditions of a fixed rate loan. The lender must also give certain additional disclosures at least 3 days before closing. Regardless of right of rescission provisions, the borrower will have 3 days after consummation to rescind the loan (includes purchases). The bill revises the current statutory disclosures under s. 494.00792, F.S., to include a statement that the borrower might be able to obtain a loan at a lower cost. The bill eliminates the provision allowing certain disclosures to be made by telephone.

The bill revises provisions relating to the right to cure the default of a subprime loan in s. 494.00794, F.S. Under current law, a lender is required to notify the borrower 45 days prior to taking any action to foreclose a high-cost home loan, which may allow the borrower to cure the default and prevent foreclosure. However, the lender is only required to do this two times over the term of the loan. A lender is not required to provide such notice thereafter and the borrower is not entitled to cure a default for a third or subsequent incident. The bill eliminates the requirement that the lender only has to provide two such notices. This change would give a borrower the unlimited right to reinstate the loan over the life of the loan.

The bill revises enforcement provisions in s. 494.00796, F.S.. A lender acting in good faith that fails to comply with this act would not be deemed to have violated the act if the lender provides restitution to the borrower and appropriate adjustments to the loan within 30-60 days after the loan closing and prior to the receiving any notice from the borrower of the compliance failure. The bill deletes current law, which provides that a lender who unintentionally violates the act, due to a good faith, bona fide error, shall not be deemed to have violated the act if the lender notifies the borrower within 60 days of the error and makes appropriate restitution and adjustment to the loan. The bill deletes current law, which provides that any person or the agent, officer, or other representative of any person committing a material violation of the act shall forfeit the entire interest charged, and only the principal sum can be enforced.

The bill creates additional remedies for violations of this act. Violations of this act are also violations of the Florida Deceptive and Unfair trade Practices Act, Part II of Chapter 501, F.S. However, the Florida Deceptive and Unfair Trades Practices Act does not apply to banks and savings loan associations regulated by the Office of Financial Regulation or federal agencies pursuant to s. 501.212, F.S.

Under current law, the office is authorized to impose an administrative penalty of up to $5,000 for a violation of the act, up to $500,000 for all violations that could have been asserted at the time of the order. The office may conduct investigations and examinations; bring an action on behalf of the State to enjoin any person violating the act; and issue cease and desist orders. In addition, any violation of the Florida Fair Lending Act is deemed a violation of ss. 494, 516, 520, 655, 657, 658, 660, 663, 665, and 667, F.S., under which different types of lenders and brokers are licensed in Florida.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill provides additional consumer protections by providing additional disclosures and restrictions on the terms of loans meeting the definition of a “subprime loan.” The disclosures would assist a borrower in understanding the costs of a loan.

The bill could potentially reduce the credit availability in the marketplace and increase the costs of mortgage loans in this state due to the additional restrictions. The marketability of these loans on the secondary market could be impaired or eliminated due to the additional requirements and perceived risks to such investors.

All lenders except national banks, federal thrifts, federal credit unions, and their subsidiaries (federal preemption) will most likely be covered by this act. (See Related Issues, below.)

C. Government Sector Impact:

Implementation of the bill could result in additional workload for the office in terms of increased examinations or investigations to determine if persons have violated the provisions of the act.

VI. Technical Deficiencies:

The bill provides that violations of this act are also violations of the Florida Deceptive and Unfair trade Practices Act, Part II of Chapter 501, F.S. However, the Florida Deceptive and Unfair Trades Practices Act does not apply to banks and savings loan associations regulated by the Office of Financial Regulation or federal agencies pursuant to s. 501.212, F.S.

VII. Related Issues:

In 2004, the federal Office of the Comptroller of the Currency (OCC) issued new rules providing that its regulations preempt state laws that conflict with a national banks' exercise of its banking powers. The OCC's rules provide that state laws do not apply to national banks if such laws, "obstruct, impair, or condition" the banks' federally authorized activities and that only the OCC has visitorial powers for national banks. This appears to preempt many state laws dealing with fair lending and consumer protection.[5] Type of real estate lending laws that are preempted include, but not limited to laws that limit terms of credit, including schedule for repayment, amortization of loans, balance, payments due, or term to maturity. This would appear to exempt national banks and subsidiaries from state laws that address predatory lending practices by limiting or prohibiting balloon payments and prepayment fees, restricting refinancing within a certain period for some types of loans.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

[5] Bank Activities and Operations: Real Estate Lending and Appraisals (12 CFR 7 and 34), 69 Fed. Reg. 1904 (January 13, 2004).

B. Amendments:

None.