HOUSE RESEARCH
Bill Summary

FILE NUMBER: H.F. 1004 **DATE:** March 22, 2007

Version: First engrossment

Authors: Davnie and others

Subject: Predatory lending

Analyst: Tom Pender, 651-296-1885

Overview

This bill contains several provisions designed to reduce predatory lending. "Predatory lending" is the term used to refer to residential mortgage lending practices that are considered harmful to the borrower. The bill regulates mortgage lenders that make the loans and mortgage brokers that arrange the loans.

Section

1 **Investment grade.** Defines this term to mean a rating of a mortgage loan on the basis of its perceived risk of default, as shown by its interest rate and discount points.

2 **Prime loan.** Defines this term as a mortgage loan that is of the highest investment grade (lowest risk of default) and designated with a letter grade of A.

3 **Subprime loan.** Defines this term as a mortgage loan that is of a lower investment grade than prime and designated with a letter grade of A- or lower.

4 **Fully indexed rate.** Defines this term as the index rate prevailing when a mortgage loan is made, plus the margin (increase) that will apply after a (lower) introductory interest rate expires.

5 **Generally.** (a) The new clause (23) prohibits a lender or mortgage broker from making or arranging a mortgage loan, unless the lender or mortgage broker has determined that the borrower has a reasonable ability to make the loan payments. Specifies how the lender or broker is required to do that, taking into account real estate taxes, homeowner's insurance, and private mortgage insurance if required.

The new clause (24) prohibits "churning," which is defined as making or arranging a new

Section

loan to refinance an existing loan when the new loan does not provide a net tangible benefit to the borrower, considering all of the circumstances. States some of the circumstances to be considered. Specifies the circumstances in which a court must presume that churning has occurred.

The new clause (25) requires the lender or mortgage broker, when informing a prospective borrower of the monthly payment on a first-lien mortgage loan, to also tell the borrower that additional amounts for property taxes and homeowner's insurance will also be payable monthly. Exempts situations in which the borrower has an existing loan that does not have an escrow account.

The new clause (26) prohibits mortgage loans, other than reverse mortgages, that could result in negative amortization. Negative amortization is when the monthly payment is less than the interest, leading to the balance owing on the loan increasing rather than decreasing over time.

(b) Provides that existing clause (22) and new clauses (23) to (25) do not apply to federally chartered or state-chartered banks, savings banks, and credit unions, or to anyone making or arranging a loan made by the state or by a tribal or local government.

6 **Financed interest, points, finance charges, fees, and other charges.** The existing provision being amended here limits the closing costs and other loan-related fees and charges (called "lender fees" in the law) that can be included in the amount of the mortgage loan that is ("financed") rather than paid at the closing (or not charged to the borrower in the first place). Items that are financed will of course result in the borrower paying more interest over the course of the loan. This existing law limits the lender fees that can be financed to 5 percent of the amount of the loan. This section of the bill adds some items to the definition of lender fees and removes them from the list of items that are not now included in lender fees. The items added to "lender fees" are certain payments made to third parties, including fees paid by the lender to a mortgage broker. The effect is to further limit the charges and fees that can be financed.

7 **Disclosure requirements for certain residential mortgage lenders.** Subdivision 1 exempts mortgage brokers from a requirement to disclose to prospective borrowers that the mortgage originator or person exempt from licensing as a mortgage lender is not acting as their agent. This section goes with section 9, which gives the mortgage brokers another role not consistent with that disclosure. Subdivision 4 provides that compliance with a HUD disclosure requirement satisfies the disclosure requirement of subdivision 2 of this section.

8 **Compliance.** Provides that mortgage originators that accept an advance fee or act as the borrower's agent have a fiduciary duty to the borrower that includes all fiduciary duties in statute or common law.

9 **Mortgage broker fiduciary duties.** Subjects mortgage brokers to the standard of a fiduciary in protecting the best interests of the borrower, which is a different standard than the one in the existing law amended in section 7, which allowed them to give a disclosure to the contrary.