74th OREGON LEGISLATIVE ASSEMBLY--2007 Regular Session

B-Engrossed

Senate Bill 965

Ordered by the House June 11
Including Senate Amendments dated May 8 and House Amendments dated June 11

Sponsored by Senators AVAKIAN, BROWN, METSGER, MONNES ANDERSON; Senator CARTER

SUMMARY

The following summary is not prepared by the sponsors of the measure and is not a part of the body thereof subject to consideration by the Legislative Assembly. It is an editor's brief statement of the essential features of the measure.

Requires lenders involved in residential property nontraditional mortgage products to ensure loan terms and underwriting standards for products and consider borrower's repayment capacity and risk mitigation factors. Requires lenders involved in residential property nontraditional mortgage products to establish risk management practices, maximum risk levels, controls, procedures and training programs to avoid lender over-reliance on nontraditional mortgage products. Requires disclosures by lender when soliciting, describing, offering, originating or servicing residential property nontraditional mortgage product.

Authorizes Director of Department of Consumer and Business Services to bring action to enjoin violation of provisions of Act. Authorizes court to impose fine of not more than $5,000 for each violation and to appoint receiver for person, or person's assets, who has violated any provision of Act.

Provides **Director of** Department of Consumer and Business Services with investigation and enforcement authority. Allows imposition of civil penalties for lender violations, not to exceed $5,000 per violation or $20,000 per continuing violation.

Creates private cause of action for damages.

Declares emergency, effective on passage.

A BILL FOR AN ACT

Relating to lending practices; and declaring an emergency.

Be It Enacted by the People of the State of Oregon:

TITLE

<u>SECTION 1.</u> **Sections 2 to 15 of this 2007 Act shall be known and may be cited as the Oregon Home Loan Fairness Act.**

DEFINITIONS

<u>SECTION 2.</u> **As used in sections 2 to 15 of this 2007 Act:**

(1) "Fully amortizing" means the process of evaluating what payment of the principal and interest on a loan through regularly scheduled installments would be for the life of a loan.

(2) "Fully indexed rate" means the index rate prevailing at origination of a mortgage product plus the margin that will apply after the expiration of any introductory interest rate.

(3) "Interest-only mortgage loan" means a mortgage on which, for a specified number of years, the borrower is required to pay only the interest due on the loan.

(4) "Lender":

NOTE: Matter in **boldfaced** type in an amended section is new; matter [*italic and bracketed*] is existing law to be omitted. New sections are in **boldfaced** type.

(a) Means a mortgage banker or mortgage broker, both as defined in ORS 59.840, or a person licensed under the provisions of ORS chapter 725.

(b) Does not mean:

(A) A bank as defined in ORS 706.008 or a bank affiliate or subsidiary; or

(B) A credit union as defined in ORS 723.006 or 723.008 or a credit union affiliate or subsidiary.

(5) "Margin" means the number of percentage points a lender adds to the index value to calculate the adjustable rate mortgage interest rate at each adjustment period.

(6) "Negative amortization" means the practice of adding unpaid interest to the mortgage loan principal, causing the principal balance to increase rather than decrease because the mortgage payments do not cover the full amount of interest due.

(7) "Nontraditional mortgage product" means a loan that is secured by a mortgage or trust deed on real property in this state upon which is or will be located a structure, or structures, intended for occupancy by one to four families and by the borrower as a principal residence and that is:

(a) An interest-only mortgage loan the Director of the Department of Consumer and Business Services identifies as a nontraditional mortgage product;

(b) A payment option adjustable rate mortgage; or

(c) Any loan the director identifies as a nontraditional mortgage product and that has:

(A) Negative amortization;

(B) Short-term introductory interest rates; or

(C) Reduced documentation.

(8) "Payment option adjustable rate mortgage" means a mortgage that allows the borrower to choose from a number of different payment options, such as:

(a) A minimum payment option that can be less than the interest accruing on the loan, resulting in negative amortization;

(b) An interest-only payment option that does not provide for principal amortization but avoids negative amortization by recasting the required monthly payment amount, after a specified number of years or if the loan reaches a certain negative amortization cap, to require payments that will fully amortize the outstanding balance over the remaining loan term; or

(c) A fully amortizing principal and interest payment option.

(9) "Qualified automated underwriting system" means:

(a) An electronic or computer program commonly used in the lending industry that is developed, reviewed or accepted for underwriting purposes by the Office of Federal Housing Enterprise Oversight, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation; or

(b) An electronic or computer program that is developed for proprietary use by a lender and accepted for underwriting purposes by the Office of Federal Housing Enterprise Oversight, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, any other federal housing authority or federal government service or the department.

(10) "Reduced documentation" means a loan feature in which the lender sets reduced or minimal documentation standards to substantiate the borrower's income and assets.

(11) "Simultaneous second-lien loan" means a lending arrangement in which either a closed-end second lien or a home equity line of credit is originated simultaneously with the

first-lien mortgage loan.

FINDINGS

SECTION 3. (1) The Legislative Assembly finds and declares that:

(a) Residential mortgage lending has traditionally been a conservatively managed business with low delinquencies and reasonably stable underwriting standards.

(b) The market has expanded rapidly for nontraditional mortgage products that are being offered by lenders to a wider spectrum of borrowers, many of whom may not fully understand the associated risks.

(c) Many of the nontraditional mortgage loans offered have been underwritten with less stringent income and asset verification requirements and have been combined with simultaneous second-lien loans. The resulting risk layering, when combined with the broader marketing of nontraditional mortgage loans, exposes lenders to increased risk relative to traditional mortgage loans.

(d) Despite having increased risk, nontraditional mortgage loans can be appropriate if responsible lenders follow sound underwriting, risk management and consumer protection standards.

(e) The recent increase in the use of nontraditional mortgage products has brought with it lending practices that have left many homeowners with loans they cannot afford to repay.

(f) With home prices falling in many areas of the country, and with millions of mortgage terms poised to reset, the national economy is threatened with the prospect of mass foreclosures.

(g) Oregon has not yet experienced the rapid rates of falling home prices and rising foreclosures seen throughout much of the nation, and there is still time to take effective action that will prevent thousands of Oregonians from entering into high-risk mortgages and facing unnecessary foreclosures in the future.

(2) The Legislative Assembly intends that the Oregon Home Loan Fairness Act protect Oregon's economy from the threat of widespread foreclosures and provide homeowners with access to home loans on fair and equitable terms.

LOAN TERMS AND UNDERWRITING STANDARDS

SECTION 4. (1) A lender offering, originating or servicing a nontraditional mortgage product shall ensure that loan terms and underwriting standards for the product are consistent with prudent lending practices, including consideration of a borrower's repayment capacity. The underwriting standards shall address the effect of a substantial payment increase on the borrower's capacity to repay when loan amortization begins. The lender may not cede underwriting standards to third parties that have different business objectives, risk tolerances or core competencies. The mortgage product terms must be based on an analysis of potential exposures and compensating factors to ensure risk levels remain manageable.

(2) The qualifying standards for a lender offering or originating nontraditional mortgage products shall recognize the potential impacts for borrowers with high loan-to-value ratios, high debt-to-income ratios and low credit scores. A lender shall consider those factors jointly in the qualification process and shall develop reasonable tolerances for each factor, based

upon underwriting standards that consider the characteristics of the borrower and the attributes of the mortgage product.

(3) A lender that offers or originates a nontraditional mortgage product shall analyze a borrower's repayment capacity, including an evaluation of the ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule.

(4) The use of a qualified automated underwriting system to underwrite and approve a loan creates a rebuttable presumption that the lender has underwritten and approved the loan in compliance with the requirements of subsections (1) to (3) of this section.

(5) The analysis of repayment capacity may not use credit scores as a substitute for verification of the borrower's income in the underwriting process and verification of the borrower's assets and outstanding liabilities. For mortgage products that permit negative amortization, the repayment analysis shall be based upon the initial loan amount plus any balance increase that may accrue from the negative amortization provision.

(6) Lenders offering, originating or servicing nontraditional mortgage products may not use loan terms and underwriting practices that rely on the sale or refinancing of the property once amortization begins.

SECTION 5. (1) Lenders that originate or purchase mortgage loans that combine nontraditional features, such as combining interest-only mortgage loans with reduced documentation or with a simultaneous second-lien loan, shall demonstrate that risk mitigating factors support the underwriting decision and the borrower's repayment capacity. Risk mitigating factors may include, but are not limited to, higher credit scores, lower loan-to-value and debt-to-income ratios, significant liquid assets, mortgage insurance or other credit enhancements.

(2) A lender offering or originating a nontraditional mortgage product shall have established written policies that comply with rules of the Director of the Department of Consumer and Business Services limiting reliance on reduced documentation, particularly with respect to unverified income, to qualify borrowers for nontraditional mortgage loans. The policies shall require that the lender exercise increasing diligence to verify and document a borrower's income and debt reduction capacity as the level of credit risk increases.

(3) A lender may not originate a nontraditional mortgage product with minimal or no owner equity and a payment structure allowing for delayed or negative amortization unless other risk mitigating factors support the underwriting decision and the borrower's repayment capacity as required by rules of the director. If a nontraditional mortgage product uses introductory interest rates, the lender shall consider the spread between the introductory rate and the fully indexed rate in determining borrower repayment capacity.

RISK MANAGEMENT PRACTICES

SECTION 6. (1) Lenders that originate or invest in nontraditional mortgage products shall adopt risk management practices for the products. The risk management practices shall include, but need not be limited to:

(a) Developing written policies that specify acceptable product attributes, production, sales and securitization practices and risk management expectations; and

(b) Designing enhanced performance measures and management reporting to provide early warning for increasing risk.

(2) Lender policies for nontraditional mortgage lending activity shall set maximum levels of risk through the lender's operating practices and policy exception tolerances. The policies shall include risk layering limits, risk management tools and practices and loan monitoring systems. The policies shall also include reviewing employee and third party incentive programs to avoid producing higher concentrations of nontraditional mortgage products than are normal for the lender.

(3) A lender shall design quality control, compliance and audit procedures to focus on mortgage lending activities that pose high risk. The procedures shall include controls to monitor compliance with underwriting standards and monitor exceptions to those standards. Lenders shall have systems and controls in place for establishing and maintaining relationships with third-party originators, including procedures for performing due diligence. Lender oversight of third parties shall involve monitoring the quality of originated nontraditional mortgage products to ensure that the products reflect the lending standards of the lender and comply with applicable laws and regulations. Lenders shall develop and use control systems to monitor whether the lender's actual practices are consistent with the policies and procedures of the lender relating to nontraditional mortgage products, including monitoring compliance, consumer information and risk management.

SECTION 7. (1) Lenders that offer or originate nontraditional mortgage products shall train their lending personnel to convey information to consumers about the product terms and risks in a timely, accurate and complete manner. If the lender offers new or additional nontraditional mortgage products, the lender shall provide lending personnel with additional training, as necessary, to enable the lending personnel to convey information to consumers in a timely, accurate and complete manner. The lender shall monitor lending personnel to determine whether the personnel are conveying information in the manner required.

(2) Lenders shall review consumer complaints to identify potential noncompliance and other risks. The review shall include legal review as appropriate and review to ensure that compensation programs do not improperly encourage lending personnel to direct consumers to particular products.

(3) Lenders that originate, invest in or service nontraditional mortgage products using a mortgage broker, correspondent or other third party shall take appropriate steps to ensure the third-party practices comply with sections 2 to 9 of this 2007 Act. Appropriate steps include, but are not limited to:

(a) Conducting due diligence and establishing other criteria for entering into and maintaining relationships with a third party;

(b) Designing third-party compensation incentives to avoid nontraditional mortgage product originations that are inconsistent with sections 2 to 9 of this 2007 Act;

(c) Setting requirements for agreements with a third party;

(d) Establishing procedures and systems to monitor third-party compliance with applicable agreements, policies and laws; and

(e) Implementing appropriate corrective actions if a third party fails to comply with applicable agreements, policies or laws.

CONSUMER PROTECTION STANDARDS

SECTION 8. (1) Advertisements, oral statements, promotional materials, monthly state-

ments and other communications to consumers for the purpose of soliciting nontraditional mortgage product business must disclose in nontechnical language the risks of nontraditional mortgage products including, but not limited to, the risk of potential increases in payment obligations and the risk of negative amortization.

(2) Prior to a potential borrower making a nontraditional mortgage product choice, a lender shall provide the borrower with sufficient information, stated in nontechnical language, to allow the borrower to understand the terms and relative risks of the available products. The information must include descriptions of the costs, terms, features and risks of the available products. If the lender offers both reduced and full documentation loan programs and there is a pricing premium attached to the reduced documentation program, the information shall disclose the premium.

(3) Lenders shall directly inform potential borrowers choosing a nontraditional mortgage product of the risks associated with the product including, but not limited to, the likelihood of increased future payment obligations. The lender shall provide the information required by this subsection before originating the nontraditional mortgage product transaction. The information required by this subsection is in addition to any information disclosure required under the federal Truth in Lending Act (15 U.S.C. 1601 et seq.).

(4) At the time of originating a nontraditional mortgage product, the lender shall disclose to the borrower in nontechnical language:

(a) The risk of potential increases in payment obligations, including circumstances in which interest rates or negative amortization reach a contractual limit.

(b) The risk of other material changes in payment obligations, such as balloon payments.

(c) If negative amortization is possible, the potential for increasing principal balances, decreasing home equity and other potential adverse consequences of negative amortization.

(d) If the lender may impose a prepayment penalty, the amount or method of determining the amount of the penalty.

(5) A lender may not falsely represent to a borrower that initial minimum payments in a payment option adjustable rate mortgage will cover accrued interest charges or cover principal and interest charges or claim that the interest rates or payment obligations for the mortgage are fixed.

SECTION 9. (1) A lender that provides to a borrower a monthly statement on a payment option adjustable rate mortgage shall include on the monthly statement:

(a) An explanation of each payment option available and the impact of that choice on loan balances;

(b) An explanation, if applicable, next to the minimum payment amount that making the minimum payment would result in an increase to the borrower's outstanding loan balance;

(c) The borrower's current loan balance;

(d) The portions of the borrower's previous payment allocated to principal and to interest; and

(e) If applicable, the amount by which the loan principal balance has increased since the previous monthly statement.

(2) A monthly statement for a payment option adjustable rate mortgage may not be in a format that emphasizes or makes it easier for the borrower to select the option of a nonamortizing or negatively amortizing payment.

RULEMAKING AND ENFORCEMENT

SECTION 10. The Director of the Department of Consumer and Business Services may adopt rules to administer and enforce sections 2 to 9 of this 2007 Act.

SECTION 11. (1) If the Director of the Department of Consumer and Business Services has reasonable cause to believe that a person has engaged or is engaging in any violation of any provision of sections 2 to 9 of this 2007 Act, a rule of the director adopted under section 10 of this 2007 Act or an order of the director to enforce a provision of sections 2 to 9 of this 2007 Act, the director may bring suit in the name and on behalf of the State of Oregon in the circuit court of any county of this state to enjoin the violation and to enforce compliance with the provision, rule or order. Upon a proper showing, a court shall grant a permanent or temporary injunction, restraining order or writ of mandamus.

(2) The court may fine the person against whom the court order is entered under subsection (1) of this section not more than $5,000 for each violation. The fine shall be entered as a judgment and paid to the General Fund of the State Treasury. Each violation of the court order is a separate offense. For a continuing violation, each day's continuance is a separate violation, but the maximum penalty for any continuing violation may not exceed $20,000 for each offense.

(3) If the court finds that the person has violated any provision of sections 2 to 9 of this 2007 Act, a rule of the director adopted under section 10 of this 2007 Act or an order of the director to enforce a provision of sections 2 to 9 of this 2007 Act, the court may appoint a receiver, who may be the director, for the person or the person's assets. The court may not require the director to post a bond. The court may award reasonable attorney fees to the director if the director prevails in an action under this section. The court may award reasonable attorney fees to a person who prevails in an action under this section if the court determines that the director had no objectively reasonable basis for asserting the claim or no reasonable basis for appealing an adverse decision of the trial court.

(4) The director may include in any action authorized by this section:

(a) A claim for restitution or damages under section 12 of this 2007 Act on behalf of the persons injured by the act or practice constituting the subject matter of the action. The court shall have jurisdiction to award appropriate relief to the persons, if the court finds that enforcement of the rights of the persons by private civil action, whether by class action or otherwise, would be so burdensome or expensive as to be impractical; or

(b) A claim for disgorgement of illegal gains or profits derived. Any recovery under this paragraph shall be turned over to the General Fund of the State Treasury unless the court requires other disposition.

SECTION 12. (1) A lender is liable for damages in the amount of the ascertainable loss to any person who suffers any ascertainable loss of money or property, real or personal, in a nontraditional mortgage product transaction if the lender transacts business as a lender in violation of any provision of sections 2 to 9 of this 2007 Act, a rule of the Director of the Department of Consumer and Business Services adopted under section 10 of this 2007 Act or an order of the director to enforce a provision of sections 2 to 9 of this 2007 Act.

(2) A person whose sole function in connection with a nontraditional mortgage product is to provide ministerial functions of escrow, custody or deposit services in accordance with applicable law is liable only if the person participates or materially aids in the nontraditional

mortgage product transaction and the plaintiff sustains the burden of proof that the person knew of the existence of the facts on which liability is based or that the person's failure to know of the existence of such facts was the result of the person's recklessness or gross negligence.

(3) An action or suit may not be commenced under this section more than three years after origination of the nontraditional mortgage product transaction.

(4)(a) Subsection (2) of this section does not limit the liability of any person for conduct other than in the circumstances described in subsection (2) of this section; or

(b) Under any other law.

(5) Except as provided in subsection (6) of this section, the court may award reasonable attorney fees to the prevailing party in an action under this section.

(6) The court may not award attorney fees to a prevailing defendant under the provisions of subsection (5) of this section if the action under this section is maintained as a class action pursuant to ORCP 32.

<u>**SECTION 13.**</u> **(1) In addition to all other penalties and enforcement provisions provided by law, any person who violates or who knowingly aids or abets in the violation of any provision of sections 2 to 9 of this 2007 Act, a rule of the Director of the Department of Consumer and Business Services adopted under section 10 of this 2007 Act or an order of the director to enforce a provision of sections 2 to 9 of this 2007 Act is subject to a civil penalty of not more than $5,000 for every violation, which shall be paid to the General Fund of the State Treasury.**

(2) Every violation is a separate offense and, in the case of a continuing violation, each day's continuance is a separate violation, but the maximum penalty for any continuing violation may not exceed $20,000 for each offense.

(3) Civil penalties under this section shall be imposed as provided in ORS 183.745.

<u>**SECTION 14.**</u> **(1) The Director of the Department of Consumer and Business Services may make such public or private investigations within or outside this state as the director deems necessary to determine whether a person has violated or is about to violate any provision of sections 2 to 9 of this 2007 Act or any rule or order of the director, or to aid in the enforcement of sections 2 to 9 of this 2007 Act or in the formulation of rules under sections 2 to 9 of this 2007 Act.**

(2) For the purpose of an investigation or proceeding under sections 2 to 9 of this 2007 Act, the director may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of books, papers, correspondence, memoranda, agreements or other documents or records that the director deems relevant or material to the inquiry. Each witness who appears before the director under a subpoena shall receive the fees and mileage provided for witnesses in ORS 44.415 (2).

(3) If a person fails to comply with a subpoena so issued or a party or witness refuses to testify on any matters, the judge of the circuit court or of any county, on the application of the director, shall compel obedience by proceedings for contempt as in the case of disobedience of the requirements of a subpoena issued from the court or a refusal to testify before the court.

(4) The director may require or permit a person to file a statement in writing, under oath or otherwise as the director determines, as to all the facts and circumstances concerning the matter to be investigated.

(5) The director may publish information concerning any violation of sections 2 to 9 of this 2007 Act or any rule or order of the director.

(6) If the director has reason to believe that any person has engaged, is engaging or is about to engage in any violation of sections 2 to 9 of this 2007 Act, the director may issue an order, subject to section 15 of this 2007 Act, directed to the person to cease and desist from the violation or threatened violation.

SECTION 15. (1) Except as provided in ORS 183.745, upon the entry of an order of the Director of the Department of Consumer and Business Services to enforce a provision of sections 2 to 9 of this 2007 Act, the director shall promptly give appropriate notice of the order as provided in this subsection. The notice shall state that a hearing will be held on the order if a written demand for hearing is filed with the director within 20 days after the date of service of the order. The director shall give notice regarding an order entered under section 14 of this 2007 Act to all interested persons.

(2) If timely demand for a hearing is filed by a person entitled to notice of the order, the director shall hold a hearing on the order as provided by ORS chapter 183. In the absence of a timely demand for a hearing, a person is not entitled to judicial review of the order.

(3) After the hearing, the director shall enter a final order vacating, modifying or affirming the previous order of the director.

PREPAYMENT

SECTION 16. (1) As used in this section:

(a) "Annual percentage rate" means the annual percentage rate for a home loan calculated according to the provisions of the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the regulations adopted thereunder by the Federal Reserve Board.

(b) "Home loan" means a home loan, including an open-end loan plan as defined in ORS 725.345, other than a reverse mortgage transaction, in which:

(A) The principal amount of the loan does not exceed the conforming loan size limit for a comparable dwelling as established from time to time by the Federal National Mortgage Association;

(B) The borrower is a natural person;

(C) The debt is incurred by the borrower primarily for personal, family or household purposes;

(D) The loan is secured by a mortgage or trust deed on real estate upon which there is located or is to be located a structure or structures, intended principally for occupancy of one to four families, that is or will be occupied by the borrower as the borrower's principal dwelling; and

(E) The property described in subparagraph (D) of this paragraph is located in this state.

(c) "Lender" means a financial institution as defined in ORS 706.008, a savings association as defined in ORS 722.004 or a mortgage banker as defined in ORS 59.840.

(2) If a lender makes a home loan with an annual percentage rate in excess of six percent, the borrower has the right to prepay all or part of the loan at any time. If a lender makes a home loan with a variable rate, the borrower has the right at any time the rate is in excess of six percent to prepay all or part of the loan. If the prepayment occurs at least one year after the loan is made, or after the loan rate has continued to be in excess of six

percent for at least one year, the lender may not charge the borrower a prepayment penalty. If the prepayment occurs less than one year after the loan is made, or after the loan rate has continued to be in excess of six percent for less than one year, the lender may not charge the borrower a prepayment penalty unless the loan document expressly provides for a prepayment penalty and the lender has complied with ORS 82.160.

(3) Subsection (2) of this section does not apply to any loan under a federal program requiring the imposition of a prepayment penalty.

APPLICABILITY

SECTION 17. (1) Sections 2 to 10, 11 (1) to (3) and (4)(b) and 13 to 15 of this 2007 Act apply to nontraditional mortgage products originated on or after the effective date of this 2007 Act.

(2) Sections 11 (4)(a) and 12 of this 2007 Act apply to nontraditional mortgage products originated on or after July 1, 2008.

(3) Section 16 of this 2007 Act applies to home loans originated on or after the effective date of this 2007 Act.

CAPTIONS

SECTION 18. The unit captions used in this 2007 Act are provided only for the convenience of the reader and do not become part of the statutory law of this state or express any legislative intent in the enactment of this 2007 Act.

EMERGENCY CLAUSE

SECTION 19. This 2007 Act being necessary for the immediate preservation of the public peace, health and safety, an emergency is declared to exist, and this 2007 Act takes effect on its passage.