STORAGE NAME: h1471a.ba.doc
DATE: February 4, 2002

HOUSE OF REPRESENTATIVES
COMMITTEE ON
BANKING
ANALYSIS

BILL #: HB 1471 (c SB 2262)

RELATING TO: The Florida Fair Lending Act

SPONSOR(S): Representative(s) Kendrick, Rubio, Bean, Alexander, Flanagan, Betancourt, and Stansel

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

(1) BANKING YEAS 8 NAYS 0
(2) FISCAL POLICY AND RESOURCES
(3) COUNCIL FOR COMPETITIVE COMMERCE
(4)
(5)

I. SUMMARY:

Sub prime lending represents a conventional lending tool that allows individuals with less than sterling credit to purchase a home or acquire products and services. Federal and state regulators have identified what is characterized as "predatory lending," as practices in which lenders make loans to borrowers with high interest rates and fees, sometimes with little or no regard to the borrower's ability to repay the loan. These practices generally take advantage of vulnerable borrowers' inexperience and lack of information, and may involve deception, misrepresentation and fraud. Such lenders reportedly solicit customers through telemarketing, direct mail and home visits, and promise lower monthly payments and fail to disclose that the borrowers' costs will, in the long run, be significantly inflated.

This bill creates specific state regulation by the Department of Banking and Finance (the department) for high-cost home loans, providing parameters for the sub-prime market that mirror safeguards found in the federal Home Ownership and Equity Protection Act (HOEPA). These limitations include prohibiting the lender from: retaining unilateral power to accelerate the indebtedness; charging balloon payments; creating a negative amortization payment schedule; automatically increasing the interest rate after default; charging advance payments from the loan proceeds; and charging modification or deferral fees. In addition, the bill prohibits lenders from making high-cost home loans without first providing for home ownership counseling and determining that the prospective borrower will be able to make the scheduled payments, and restricts the fees and home improvement contracts that lenders of these loans may impose.

This bill also pre-empts local government rules or ordinances aimed at regulating "high-cost home loans" or the "sub prime" lending market and prohibiting practices that have been described as "predatory lending." Although no local ordinance exists at this time, local governments in south Florida are considering such, and the potential of myriad, disparate local laws disrupting legitimate consumer lending statewide is high. The bill does not include specific penalties for violations of the Act.

The Act becomes effective October 2, 2002. There does not appear to be a fiscal impact to General Revenue, nor does it appear to affect the private sector in a significant way, apart from educating the general public seeking high-cost home loans.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1. Less Government Yes [] No [x] N/A []

   The bill creates a new layer of governmental regulation for the Department of Banking and Finance.

2. Lower Taxes Yes [] No [] N/A [x]

3. Individual Freedom Yes [x] No [] N/A []

4. Personal Responsibility Yes [x] No [] N/A []

5. Family Empowerment Yes [] No [] N/A [x]

   For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Legitimate Sub prime Lending and Illegitimate Predatory Lending Practices

A distinction has been made between what has come to be known as "predatory lending" and "sub prime lending." According to the Federal Deposit Insurance Corporation (the FDIC), sub prime lending refers to entirely appropriate and legal lending to borrowers who do not qualify for prime rates; those rates reserved for borrowers with virtually blemish-free credit histories. According to lenders, the premiums for extending credit to sub prime borrowers compensate lenders for the increased risk that they incur and range several percentage points over rates charged on prime loans. Sub prime lending permits borrowers, who otherwise would not be able to borrow money for a home, access to the market.

Predatory lending, on the other hand, refers to activities and practices such as asset-based lending (for those who may be "house rich but cash poor"), loan flipping, packing of unnecessary fees and insurance, and fraudulent or deceptive practices. Such practices are already illegal under existing federal and state laws.

Although not all victims of predatory lending practices are sub prime borrowers, predatory lenders may target sub prime borrowers because they are often more vulnerable and have fewer alternatives than other borrowers. Rather than discourage the sub prime market, the FDIC believes safe and sound, well-managed sub prime lending programs, with appropriate capitalization and loan pricing, provide an important source of credit for borrowers whose credit history may not permit them to qualify for the conventional "prime" loan market.[1]

The FDIC reports that the best-intentioned banks can become associated with predatory lending, inadvertently, through involvement in the mortgage and securities markets. Some banks purchase loans from loan brokers. Others have lending subsidiaries, form joint ventures with other lenders, or provide warehouse lines of credit, liquidity facilities, and dealer or broker lines. Some banks or their

[1] Source: http://www2.fdic.gov/epc/predlend/Regulation/AllSections.asp?anc=ReturnHow

subsidiaries may service loans. In addition, some banks might invest in asset-backed securities or participate in the securitization process by providing trust services or acting as an underwriter.

No law administered by the Federal Reserve Board (the Board) has a statutory or regulatory definition of "predatory lending." In response to concerns about unfair and potentially abusive practices in connection with sub prime mortgage loans, the Congress enacted the Home Ownership and Equity Protection Act of 1994 (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. While HOEPA's purpose is to regulate abusive lending practices, triggers related to a loan's annual percentage rate or its points and fees, rather than any definition of "predatory lending" determine a transaction's coverage under the act.

HOEPA's triggers may bring sub prime loans not associated with unfair or abusive lending within the act's coverage. Similarly, abusive practices may occur in transactions that fall below the HOEPA triggers. Some consumer advocates, however, have expressed the view that many sub prime loans are predatory because they believe these loans generally carry rates or fees that are excessive even in light of the additional risk involved. Others view predatory lending more narrowly, based on specific practices of particular lenders.

According to the Board, abusive practices in home equity lending take many forms, but principally fall within two categories. The first category includes the use of blatantly fraudulent or deceptive techniques that may also involve other unlawful acts. These practices occur even though they are prohibited under existing law. For example, loan applicants' income and ability to make scheduled loan payments may be falsified, signatures may be forged or obtained on blank documents, or borrowers may be charged fees that are not tied to any service rendered. A second category of abuses described in a Board report involves various techniques used to manipulate borrowers into accepting high rates or unaffordable terms, even though they may qualify for lower-cost alternatives. The loan documentation might appear to be proper and legally enforceable, but the broker or creditor may pressure consumers to enter transactions that they do not fully understand. Homeowners are charged high up-front fees that are added to the loan amount. In some cases, if there is sufficient equity in the property, the loan may be made without consideration of the borrowers' ability to repay. In other cases, a consumer may not understand that a loan with affordable monthly payments will not amortize the principal or that there will be a balloon payment that the consumer must refinance at additional cost.[2]

Federal Lending Laws

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), the Home Mortgage Disclosure Act (HMDA), the Real Estate Settlement Procedures Act (RESPA), the Fair Housing Act (FHAct), the Equal Credit Opportunity Act (ECOA) the Community Reinvestment Act (CRA), and the Home Ownership and Equity Protection Act (HOEPA).

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.

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[2] http://banking.senate.gov/docs/reports/predlend/fed.htm - Letter from Edward M. Gramlich, Member of the Board, Federal Reserve, dated April 28, 2000.

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 FHAct 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 FHAct since the ECOA covers virtually all lenders while the FHAct covers only real estate-related lending. Housing lenders are subject to both statutes.

The CRA requires the banking agencies to consider a depository institution's efforts to meet the needs of its community when it applies to the banking agencies for permission to expand. As currently interpreted by the agencies, this has meant that a bank's fair lending performance is weighed when considering such an application.

Under HOEPA, the Board has broad authority to prohibit unfair or deceptive mortgage lending practices and to address abusive refinancing practices. While this authority was conveyed in HOEPA, it covers all mortgage loans, not just closed-end refinance transactions that meet the definition of "high cost." While the substantive limitations that HOEPA imposes refer specifically to high cost mortgages, the discretionary authority granted by subsection (l) refers to "mortgage loans" generally. HOEPA regulations prohibit lenders from engaging in a pattern or practice of extending credit to consumers based on the consumer's collateral without regard to the consumers' ability to repay the loans. Under HOEPA, prepayment penalties of less than five years are allowed under certain conditions, however, balloon payments of less than five years are not allowed for high cost loans.

State Oversight

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 also 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, Truth in Lending, applies to all persons who extend consumer credit more than 25 times a year or, in the case of consumer credit secured by real estate, more than 5 times a year.

The Department of Banking and Finance regulates state-chartered financial institutions generally (Chapter 655, F.S.), Credit Unions (Chapter 657, F.S.), Banks and Trust Companies (Chapter 657, F.S.), Trusts (Chapter 660, F.S.), Associations (Chapter 665, F.S.) Savings Banks (Chapter 667, F.S.), Retail Installment Sales (Chapter 520), as well as those licensed for Mortgage Brokerage and Mortgage Lending (Chapter 494, F.S.), and Consumer Finance Companies (Chapter 516, F.S.). In addition to state oversight and regulation, these state-chartered institutions are required to comply with federal regulations governing their industries.

In addition, Florida law provides guidelines for Instruments Deemed Mortgages and the Nature of Mortgages (Chapter 697, F.S.)(the Department of Insurance), 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).

Local Ordinances

Several states and cities have enacted laws restricting or prohibiting the use of certain credit provisions commonly associated with predatory lending, such as prepayment penalties and financing of up-front fees and credit insurance premiums. Such laws typically define high-cost mortgage loans in terms of thresholds for pricing and fees. Further, some local governments have adopted ordinances declaring a moratorium on business relationships with financial institutions that originate loans with rates and terms that their rules define as "predatory" or "high cost." As might be expected, these ordinances differ considerably, with percentage rate triggers that range from the current Treasury Bill rate plus 5 percent (DeKalb County, GA), to Treasury Bill rate plus 9 percent (Dayton, Ohio), and some in between.[3] Some ordinances apply only to consumer loans that do not exceed $25,000, while others apply to open-end lines of credit but not reverse mortgages, and others apply only to loans secured by residential real estate.

C. EFFECT OF PROPOSED CHANGES:

The bill creates specific state regulation by the Department of Banking and Finance (the department) for high-cost home loans providing parameters for the sub-prime market that mirror safeguards found in the federal Home Ownership and Equity Protection Act (HOEPA). These limitations include prohibiting the lender from: retaining unilateral power to accelerate the indebtedness; charging balloon payments; creating a negative amortization payment schedule; automatically increasing the interest rate after default; charging advance payments from the loan proceeds; and charging modification or deferral fees. In addition, the bill prohibits lenders from making high-cost home loans without first providing for home ownership counseling and determining that the prospective borrower will be able to make the scheduled payments, and restricts the fees and home improvement contracts that lenders of these loans may impose.

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D. SECTION-BY-SECTION ANALYSIS:

Section 1 creates a short title: the "Florida Fair Lending Act."

Section 2 provides definitions that mirror certain United States Code sections: "Affiliate" as defined by the Federal Bank Holding Company Act; "Annual Percentage Rate" as defined in the Federal

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[3] Please see the following site for a summary of major state and local predatory lending legislation, as of October 24, 2001, http://www.butera-andrews.com/legislative-updates/directory/State/Legislature/Bills/sbc/Passed%20Legislation%20Chart.pdf, and as of January 18, 2002, by Butera & Andrews, Wash. D.C., counsel for National Home Equity Mortgage Association: http://www.butera-andrews.com/legislative-updates/directory/State/Legislature/Bills/sbc/State%20Bill%20Chart%202002.pdf

Truth in Lending Act; and "High-Cost Home Loan" as the TILA defines what is a "mortgage" under 15 USC s. 1602(aa).[4] Other defined terms include "Borrower," "Lender," "Bridge Loan," and "Residential Property."

Section 3 outlines prohibited acts:

Prepayment Penalties - The Act prohibits a high-cost home loan document from containing a prepayment penalty for paying all or part of the loan principal before the date on which the payment is due unless certain conditions are met. The lender may charge a prepayment penalty for up to the first 36 months after the loan's consummation provided: (1) the borrower is offered a choice of another product without a prepayment penalty; and, (2) at least three business days before the loan's consummation, the borrower is given a written disclosure of the terms of the prepayment penalty, including the benefit the borrower will receive through accepting the penalty, either through a reduced interest rate or reduced points or fees.

Default Interest Rate – The Act prohibits a high-cost home loan document from increasing the loan's interest rate after default on a loan. This prohibition does not apply to a loan with a variable interest rate provided the change in interest rate is not triggered by a default.

Balloon Payments – A high-cost home loan with a term of less than five years may not contain balloon payment provision.[5] This prohibition does not apply when the payment schedule is adjusted to account for seasonal income of the borrower or if the loan is a bridge loan.

Negative Amortization - A high-cost home loan may not contain terms whereby the outstanding principal balance will increase because the regular periodic payments do not cover the full amount of the interest due.

Prepaid Payments - A high-cost home loan may not contain terms whereby more than two periodic payments are consolidated and paid in advance from the loan proceeds provided to the borrower.

Extending Credit Without Regard to the Payment Ability of the Borrower – A lender providing a high-cost home loan is prohibited from extending credit based upon the borrower's collateral without regard to the borrower's ability to repay the loan.

Payments To a Home Contractor - A lender providing a high-cost home loan is prohibited from making payments to a contractor under a home improvement contract with proceeds from a high-cost loan unless the instrument is payable jointly to the borrower and the contractor, or by election of the borrower to a third-party escrow agent in accordance with a written agreement between the borrower, the lender, and the lender prior to the date of payment.

Due-On-Demand Clause – A lender may not terminate a loan in advance of the maturity date and demand repayment of the loan entire except in the case of fraud or material misrepresentation, the consumer defaults on the loan, or in the case that action or inaction on the part of the borrower affects the lender's security for the loan.

Refinancing Within a One-Year Period – A lender or its affiliate or assignee may not refinance a high-cost home loan to the same borrower when refinancing does not have a reasonable benefit to

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[4] TITLE 15 - Commerce and Trade, Chapter 41 - Consumer Credit Protection, Subchapter I - Consumer Credit Cost Disclosure – Please see http://www4.law.cornell.edu/uscode/15/1602.html for text of section.

[5] A balloon note contains terms under which the aggregate amount of the regular periodic payments would not fully amortize the outstanding principal balance.

the borrower. “Reasonable benefit” occurs when, in the totality of the circumstances, there is a lower monthly payment, a beneficial change for the borrower in the long run, the borrower receives a reasonable amount of cash in excess of and in relation to points and fees, or there is a change from an adjustable rate to a fixed rate. Lenders are prohibited from engaging in any practice that serves to evade this requirement.

Open-ended Loans – Open-ended loans are forbidden, unless the open-ended loan meets the definition in 12 C.F.R. s. 226.2(a)(20) (Truth in Lending – Regulation Z)[6].

Section 4 provides additional disclosures by lenders offering high-cost home loans to borrowers above those already required under law. These disclosures must be given not less than three business days prior to the consummation of the loan. Lenders must provide additional disclosures if the lender changes the terms of the extension of credit and any original disclosures are rendered inaccurate by the change. Additional disclosures may be made via telephone if the borrower initiates the change, if at the consummation of the loan the lender provides the disclosures in writing to the borrower and the lender and borrower certify in writing that the lender provided the additional disclosures via telephone no later than three days prior to the consummation. Disclosures include:

- The lender will have a mortgage on the borrower’s home and that the borrower could lose the home if the borrower defaults.
- The lender must explain the basis for establishing interest rates, closing costs and fees, and advise the borrower to shop around.
- The lender must ask the borrower to consider consulting a qualified independent credit counselor or financial counselor regarding rates, fees, and other obligations under the loan.
- The borrower need not complete the agreement because he or she has signed an application.
- Debt consolidation is an appropriate tool, but amassing more credit debt after consolidation could result in losing the home if there is a default.
- Property taxes and insurance are the borrower’s responsibility.
- Payments on existing debts contribute to the borrower’s credit rating.
- Disclosure of the APR on a fixed mortgage, or the amount of the monthly payment and any permitted balloon payment, if a variable mortgage, and a statement explaining that the interest rate and the payments may increase.
- Disclosure to purchasers and assignees that the mortgage is subject to the provisions of this Act, and such purchasers and assignees are liable for all claims and defenses that the borrower may assert against the lender.

Section 5 provides administrative and enforcement duties, as well as injunctive and subpoena powers to the Department of Banking and Finance. The department is authorized to promulgate rules necessary to implement the act, and to provide for electronic filing of fees and/or forms.

Section 6 provides that this Act preempts all rules, regulations, or codes of any city, county or other political subdivision of the state, or any local agency, regarding high-cost home loans made in the state.

Section 7 provides that the provisions of this Act are severable if any part is declared invalid, or if such is pre-empted by federal law or regulation.

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[6] Open-end credit means consumer credit extended by a creditor under a plan in which: (i) The creditor reasonably contemplates repeated transactions; (ii) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and (iii) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

Section 8 provides an effective date, upon becoming a law.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   See, Part III.D. FISCAL COMMENTS

2. Expenditures:

   See, Part III.D. FISCAL COMMENTS

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None

2. Expenditures:

   None

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This act may not adversely affect banks, credit unions, or other financial services companies that legitimately provide loans in the sub prime market under current federal standards. Institutions will be required to provide additional disclosures to borrowers and restrict the use of certain penalties. Consumers may benefit by the department's continuing effort to educate the public about predatory lending and by prosecuting those who employ predatory tactics to procure loans in the state.

D. FISCAL COMMENTS:

The bill does not provide for additional funding to the department for this ostensibly new regulatory role. Department representatives point out, however, that they already regulate consumer lending and mortgage brokers licensed in the state and this Act represents just another "module" of their oversight and regulation of the lending industry. This observation notwithstanding, the department is still investigating whether this Act will require additional funding to either the Banking or Finance sections of the department.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenue in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None apparent

B. RULE-MAKING AUTHORITY:

The department is authorized to promulgate rules to implement the Act, and to allow electronic filing of any fees, forms, or documents.

C. OTHER COMMENTS:

Staff called the Florida League of Cities and the Florida Association of Counties to discern those associations' opinions, if any, regarding the bill. Neither association provided an official position before publication of this analysis.

The bill does not provide for penalties for a violation of the Act. The department recommends the following language be added to page nine, after line 31:

> (5) Whenever the department finds a person in violation of this act,
> it may enter an order imposing a fine in an amount not exceeding $5,000 for each count or separate offense.

In addition, the bill does not provide a funding mechanism for investigation costs for the Banking or Finance sections of the department. According to the department this should not be much of an issue for the Banking division since few of the regulated institutions are involved in this type of lending. It may, however, be more of an issue for the Finance division of the department. This admission reinforces the argument that the problem lays not so much with the banking industry, but other consumer finance industries.

The act seeks to mirror certain federal standards as mentioned, however, the section prohibiting prepayment penalties for up to the first 36 months after the date of consummation of the loan is contrary to HOEPA, which prohibits prepayment penalties for the first 60 months.

Other technical issues include: Page 4, line 31, and on page 5, line 1, the term "consumer" should be replaced with "borrower." On page 6 line 29 there is a blank that needs to be filled.

As drafted, the department would only have the ability to do an investigation of persons that may be violating this act. To remedy this, a line permitting the department to conduct examinations of any person to determine compliance with this act could be inserted on page 9 between lines 10 and 11.

Finally, the bill becomes effective as soon as the Governor signs it. According to the department, this may not give the department and its regional staff enough time to restructure the examination procedures.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On February 20, 2002, the Committee on Banking adopted three amendments, which are traveling with the bill.

Amendment No. 1 provides direct authority for the department to examine any person for compliance with this Act.

Amendment No. 2 is technical and conforms the directory language and title to reflect examination authority given to the department in Amendment No. 1

Amendment No. 3 gives the department authority to impose on a person who violates the Act a $5,000 fine for each violation of the act, not to exceed $250,000 in the aggregate. The amendment also provides statutory cross-section violation provisions for persons licensed under Chapters 494 (Mortgage Brokers and Lenders), 516 (Consumer Finance), 520 (Retail Installment Sales), 655 (Financial Institutions, generally), 657 (Credit Unions), 658 (Trust Business), 660 (International Banking), 665 (associations), and 667 (Savings Banks). This amendment also provides very broad rulemaking authority to the department.

VII. SIGNATURES:

COMMITTEE ON BANKING:

Prepared by:	Staff Director:
Michael A. Kliner	Susan F. Cutchins