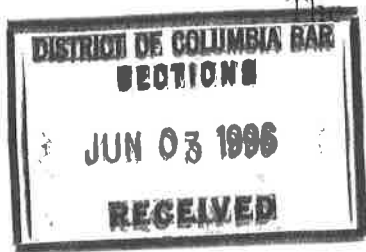


# ANTITRUST, TRADE REGULATION AND CONSUMER AFFAIRS SECTION



Robert N. Wiener  
D.C. Bar President  
Myles V. Funk  
D.C. Bar President Elect  
Katherine A. Mazzatani  
D.C. Bar Executive Director



The District of Columbia Bar

# COPY

## EXECUTIVE SUMMARY

### **Comment of the D.C. Bar Consumer Affairs Committee on Bill 11-637, the "District of Columbia Mortgage Lender and Broker Act Of 1996"**

In this comment, we identify the apparent purposes of the proposed "District of Columbia Mortgage Lender and Broker Act of 1996" and discuss whether the legislation achieves those purposes.

The bill requires licensing and regulation of unregulated entities that make residential mortgage loans, and is limited to loans where the homeowner-borrower will use the proceeds for a non-commercial purpose. We observe that the bill has a narrow focus and leaves much of D.C. mortgage lending unregulated. We note some ambiguity in the bill's purposes, and observe that certain provisions of the bill may be inconsistent with its purposes.

Although we believe that consumers need protection from unscrupulous lenders, we do not take up broad questions concerning regulation of non-bank mortgage lending, but instead focus on particular provisions of the bill. We point out that certain provisions may unintentionally exclude from the bill's coverage desperate, unsophisticated borrowers. Specifically, a lender may rely on a borrower's affidavit attesting to future business plans to establish a commercial purpose for the loan, thereby exempting the loan from the proposed law. An unscrupulous lender, however, might easily convince a desperate borrower to sign such an affidavit.

We also express concern that the bill's exemption for "[a]ny person who makes or brokers five (5) or fewer mortgage loans per calendar year" might be misused by an unscrupulous lender acting through a series of agents, none of whom engage in more than the five transactions required for regulation to apply. Thus, the exemption language permits evasion of the bill's provisions and ultimately may defeat the purpose of the legislation.

# ANTITRUST, TRADE REGULATION AND CONSUMER AFFAIRS SECTION



The District of Columbia Bar

Robert N. Weiner  
D.C. Bar President  
Myles V. Link  
D.C. Bar President-Elect  
Katherine A. Mazzatani  
D.C. Bar Executive Director

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Sections Manager

*Committees:*  
Antitrust  
Consumer Affairs

May 24, 1996

The Honorable John Ray  
Chairman Pro Tempore  
Committee on Consumer and Regulatory Affairs  
Wilson Building  
1350 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004

**Re: Comment of the Consumer Affairs Committee, Antitrust, Consumer Affairs and Trade Regulation Section, District of Columbia Bar on Bill 11-637, the "District of Columbia Mortgage Lender and Broker Act Of 1996"**

Dear Chairman Ray:

In this comment, we identify the apparent purposes of the proposed "District of Columbia Mortgage Lender and Broker Act of 1996" and discuss whether the legislation achieves those purposes.<sup>1/</sup> We observe that the bill has a narrow focus and leaves much of D.C. mortgage lending unregulated. We note some ambiguity in the bill's purposes, and observe that certain provisions of the bill may be inconsistent with its purposes.<sup>2/</sup>

Although we believe that consumers need protection from unscrupulous lenders, we do not take up broad questions of regulatory policy, but instead focus on particular provisions of the bill. We point out that certain provisions may unintentionally exclude from the bill's coverage desperate, unsophisticated borrowers. Specifically, a lender may

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<sup>1/</sup> The views expressed herein represent only those of the Antitrust, Trade Regulation and Consumer Affairs Section of the D.C. Bar, and not the views of the D.C. Bar or its Board of Governors.

<sup>2/</sup> An appendix to this comment discusses recent press reports concerning mortgage lending practices in D.C. These reports provide a useful context for considering the purposes and strategies of the proposed bill.

rely on a borrower's affidavit attesting to future business plans to establish a commercial purpose for the loan, thereby exempting the loan from the proposed law. An unscrupulous lender, however, might easily convince a desperate borrower to sign such an affidavit.

We also express concern that the bill's exemption for "[a]ny person who makes or brokers five (5) or fewer mortgage loans per calendar year" might be misused by an unscrupulous lender acting through a series of agents, none of whom engage in more than the five transactions required for regulation to apply. Thus, the exemption language permits evasion of the bill's provisions and ultimately may defeat the purpose of the legislation.

### Overview of Bill 11-637

This comment does not attempt to determine the most appropriate regulatory approach for protecting consumers from exploitation by unscrupulous lenders, but instead focuses on particular provisions of Bill 11-637. In general, the bill has a narrow scope and is by no means a comprehensive plan for regulating D.C. mortgage lenders and brokers. In fact, it includes limitations that seem to be at cross-purposes with even the narrow scope of the legislation.

The bill requires licensing and regulation of the currently unregulated non-bank entities that make residential mortgage loans, and is limited to loans where the borrower will use the proceeds for a non-commercial purpose. The legislation establishes the requirements for obtaining a license to make residential mortgage loans.<sup>3/</sup> (It is debatable whether the requirements are sufficiently rigorous, given the government imprimatur that accompanies a license, but we do not take up that question here.) The Superintendent may deny a license application to someone who committed an action prior to applying for the license that would be ground for suspension or revocation of a license under the Act.

Licensees must meet recordkeeping and reporting requirements, and submit to government examinations and investigations. Lenders making loans secured by residential realty must make disclosures of loan facts to borrowers in a manner similar to federal "Truth in Lending" law requirements.

Licensees are required to comply with a series of conduct requirements. No mortgage lender or mortgage broker required to be licensed under the act shall:

- obtain any agreement or instrument in which blanks are left to be filled in after execution;

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<sup>3/</sup> Section 4(b) requires "good moral character" and "sufficient financial responsibility, business experience, and general fitness . . ." Also, the applicant must demonstrate that he or she has funds available for capitalization of the business. A surety bond is also required.

- take an interest in collateral other than the real estate or residential property, including fixtures and appliances thereon, securing a mortgage loan;
- obtain any exclusive dealing or exclusive agency agreement from any borrower;
- delay closing on any mortgage loan for the purpose of increasing interest, costs, fees, or charges payable by the borrower;
- obtain any agreement or instrument executed by a borrower that contains an acceleration clause permitting the unpaid balance of a mortgage loan to be declared due for any reason other than failure to make timely payments of interest and principal or failure to perform other obligations undertaken in the agreement or instrument;
- if acting as a mortgage lender, fail to require the person closing the mortgage loan to provide to the borrower prior to closing of the mortgage loan a settlement statement as required pursuant to the Real Estate Settlement Procedures Act and to make disclosures required by the federal Truth in Lending Act; and
- receive compensation from a borrower until a written commitment to make a mortgage loan is given to the borrower by a mortgage lender, except for an application fee and costs of credit reports and appraisals.

Additional conduct prohibitions concern conflicts of interest between real estate sales and real estate lending functions, and escrow rules that restrict prepayment of taxes and insurance by borrowers.

Violations of the law are subject to sanctions against the license holder, including license revocation. Regulatory orders of the Superintendent of the Office of Banking and Financial Institutions are enforceable in D.C. Superior Court.

### **The Legislation is Limited in Scope**

Certain definitions in the legislation limit its coverage. A "mortgage loan" is "[a]ny loan or extension of credit that is secured, in whole or part, by any interest in residential real property in the District of Columbia if for personal, household, or family purposes, in any amount. . . . [and] does not include any loan for commercial purposes . . . ." "Residential real property" is "any owner-occupied real property . . . which property has a dwelling on it designed principally as a residence with accommodations for not more than 4 families, but does not include any real property held primarily for rental, investment, or the generation of income through any commercial or industrial enterprise."

In addition to the narrow scope of the legislation, an exemption in the bill for loans made for commercial purposes appears to be inconsistent with the basic regulatory intent of the bill. We discuss that language below.

**The Bill's Exemption for Loans Made for Commercial Purposes  
May Exclude Some Borrowers From the Bill's Protections**

A principal purpose of the bill is to regulate mortgage loans to homeowners, so that the borrower's homestead is not unnecessarily put at risk. The bill reflects a further legislative determination that this homestead protection should not be afforded where the borrower intends to apply loan proceeds to a commercial purpose.

Assuming the wisdom of limiting the bill to loans to homeowners only if made for non-commercial purposes, provisions of the bill may unintentionally exclude from its coverage desperate, unsophisticated homeowners who have no legitimate commercial purpose for the loan. In particular, the lender may, in some circumstances, rely on an affidavit of the borrower, without any supporting documentation, to establish that the loan is being made for commercial purposes, thereby placing the loan outside of the bill's coverage.<sup>4/</sup> The problem with this provision is that an unsupported affidavit promising an intention to start a commercial business in the future could be signed by virtually any homeowner in dire need of a loan. An unscrupulous lender might easily convince a desperate borrower that a loan is available only if the borrower agrees to sign an affidavit stating an intention to start a business in the future. Indeed, the anecdotes in the Washington Post articles reflect such practices. See Appendix.

**The Bill's "5 Loans or Less" Exemption Language Permits Easy Evasion**

The legislation provides that "[t]he provisions of this act do not apply to . . . [a]ny person who makes or brokers five (5) or fewer mortgage loans per calendar year." However, it does not appear that the person who "makes or brokers" a loan must also be the primary or intermediate source of the loan funds, and the definitions in the bill eschew any such requirement. The definition of "mortgage lender" includes any person who "aids or assists" any person in procuring a mortgage loan, or "engages in the business of servicing mortgage loans for others." A mortgage broker is defined as including one who "negotiates or offers to negotiate the terms and conditions of a mortgage loan on behalf of a lender."

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<sup>4/</sup> An affidavit is sufficient to establish commercial purpose if "(1) [t]he borrower is seeking funds to start a business and has not yet incorporated or prepared documentation or proof of ownership of a commercial enterprise; and (2) [t]he affidavit states the purpose for which the proceeds of the mortgage loan are to be used and the nature of the business conducted or to be conducted by the borrower."

Therefore, the true lender, or even an intermediate lender who is not the ultimate source of the loan funds, may be someone other than the nominal lender or broker at the loan closing. We are concerned that the exemption language may be exploited by unscrupulous lenders acting through individuals who "make or broker" loans pursuant to an agreement to transfer the loan to the unscrupulous lender after closing. If so, lenders would be able to avoid regulation by acting through a series of agents, none of whom is engaged in more than five transactions. In short, the exemption language may ultimately defeat the intent of Bill 11-637.

**Regulatory Alternatives Not Implemented by the Proposed Legislation**

The Washington Post articles discussed in the appendix include regulatory reforms not included in Bill 11-637.<sup>5/</sup> For example, the articles suggest the possibility of increasing judicial or regulatory oversight of the mortgage foreclosure process. This would facilitate challenge of improper foreclosures by consumers. The articles also discuss interest rate caps -- a provision not included in the proposed legislation.

We hope this comment is useful in evaluating Bill 11-637.

Sincerely,



Lisa Jose-Fales  
Margaret Leonard

Co-chairs, Consumer Affairs Committee, on behalf  
of the Steering Committee of the Antitrust, Trade  
Regulation and Consumer Affairs Section of the  
D.C. Bar

cc: Adam Smith

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<sup>5/</sup> We have not evaluated these regulatory alternatives in this comment, but are simply bringing them to the City Council's attention.