

**SUNSET EVALUATION REPORT
REGULATION OF MORTGAGE BROKERS
AND SOLICITORS**

Chapter 454, Hawaii Revised Statutes

A Report to the Governor and the Legislature of the State of Hawaii

Submitted by

**Legislative Auditor of the State of Hawaii
Honolulu, Hawaii**

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FOREWORD

Under the "Sunset Law," licensing boards and commissions and regulated programs are terminated at specific times unless they are reestablished by the Legislature. Hawaii's Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, scheduled for termination 38 licensing programs over a six-year period. These programs are repealed unless they are specifically reestablished by the Legislature. In 1979, the Legislature assigned the Office of the Legislative Auditor responsibility for evaluating each program prior to its repeal.

This report evaluates the regulation of mortgage brokers and solicitors under Chapter 454, Hawaii Revised Statutes. It presents our findings as to whether the program complies with the Sunset Law and whether there is a reasonable need to regulate mortgage brokers and solicitors to protect public health, safety, or welfare. It includes our recommendation on whether the program should be continued, modified, or repealed. In accordance with Act 136, SLH 1986, draft legislation intended to improve the regulatory program is incorporated in this report as Appendix B.

We acknowledge the cooperation and assistance extended to our staff by the Department of Commerce and Consumer Affairs and other officials contacted during the course of our examination. We also appreciate the assistance of the Legislative Reference Bureau which drafted the recommended legislation.

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TABLE OF CONTENTS

<i>Chapter</i>		<i>Page</i>
1	INTRODUCTION	1
	Objective of the Evaluation	1
	Scope of the Evaluation	1
	Organization of the Report	1
	Framework for Evaluation	2
2	BACKGROUND	5
	The Mortgage Industry	5
	Occupational Characteristics	7
3	EVALUATION OF THE REGULATION OF MORTGAGE BROKERS AND SOLICITORS	13
	Summary of Findings	13
	Need for Regulation	13
	Law Needs to be Clarified and Strengthened	18
	Weak Regulatory Program	21
	Recommendations	23
	NOTES	25
Appendix A:	Comments on Agency Responses	A-1
Appendix B:	Proposed Legislation	B-1

Chapter 1

INTRODUCTION

The Hawaii Regulatory Licensing Reform Act of 1977, or Sunset Law, repeals statutes concerning 38 occupational licensing programs over a six-year period. Each year, six to eight licensing statutes are scheduled to be repealed unless specifically reenacted by the Legislature.

In 1979, the Legislature amended the law (Chapter 26H, Hawaii Revised Statutes) to make the Legislative Auditor responsible for evaluating each licensing program prior to its repeal and to recommend to the Legislature whether the statute should be reenacted, modified, or permitted to expire as scheduled. In 1980, the Legislature further amended the law to require the Legislative Auditor to evaluate the effectiveness and efficiency of the licensing program, even if the Auditor determines that the program should not be reenacted.

Objective of the Evaluation

The objective of the evaluation is: To determine whether, in light of the policies set forth in the Sunset Law, the public interest is best served by reenactment, modification, or repeal of Chapter 454, HRS.

Scope of the Evaluation

This report examines the history of the statute on the regulation of mortgage brokers and solicitors and the public health, safety, or welfare that the statute was designed to protect. It then assesses the effectiveness of the statute in preventing public injury and the continuing need for the statute.

Organization of the Report

This report consists of three chapters: Chapter 1, this introduction and the framework for evaluating the licensing program; Chapter 2, background information on the regulated industry and the enabling legislation; and Chapter 3, our evaluation and recommendations.

Framework for Evaluation

Hawaii's Sunset Law reflects rising public antipathy toward what is seen as unwarranted government interference in citizens' lives. The Sunset Law sets up a timetable terminating various occupational licensing programs. Unless reestablished, the programs disappear or "sunset" on a prescribed date.

In the Sunset Law, the Legislature established policies on the regulation of professions and vocations. The law requires each occupational licensing program to be assessed against these policies in determining whether the program should be reestablished or permitted to expire as scheduled. These policies are:

1. The regulation and licensing of professions and vocations by the State shall be undertaken only where reasonably necessary to protect the health, safety, or welfare of consumers of the services; the purpose of regulation shall be the protection of the public welfare and not that of the regulated profession or vocation.

2. Where regulation of professions and vocations is reasonably necessary to protect consumers, government regulation in the form of full licensure or other restrictions on the professions or vocations should be retained or adopted.

3. Professional and vocational regulation shall be imposed where necessary to protect consumers who, because of a variety of circumstances, may be at a disadvantage in choosing or relying on the provider of the services.

4. Evidence of abuses by providers of the services shall be accorded great weight in determining whether government regulation is desirable.

5. Professional and vocational regulation which artificially increases the costs of goods and services to the consumer should be avoided.

6. Professional and vocational regulation should be eliminated where its benefits to consumers are outweighed by its costs to taxpayers.

7. Regulation shall not unreasonably restrict entry into professions and vocations by all qualified persons.

We translated these policy statements into the following framework for evaluating the continuing need for the various occupational licensing statutes.

Licensing of an occupation or profession is warranted if:

1. There exists an identifiable potential danger to public health, safety, or welfare from the operation or conduct of the occupation or profession.

2. The public that is likely to be harmed is the consuming public.

3. The potential harm is one against which the public cannot reasonably be expected to protect itself.

4. There is a reasonable relationship between licensing and protection of the public from potential harm.

5. Licensing is superior to other alternative ways of restricting the profession or vocation to protect the public from the potential harm.

6. The benefits of licensing outweigh its costs.

The potential harm. For each regulatory program under review, the initial task is to identify the purpose of regulation and the dangers from which the public is to be protected.

Not all potential dangers warrant the exercise of the State's licensing powers. The exercise of such powers is justified only when the potential harm is to public health, safety, or welfare. "Health" and "safety" are fairly well understood. "Welfare" means well-being in any respect and includes physical, social, and economic well-being.

This policy that the potential danger be to the public health, safety, or welfare is a restatement of general case law. As a general rule, a state may exercise its police power and impose occupational licensing requirements only if such requirements tend to promote the public health, safety, or welfare. Courts have held that licensing requirements for paperhangers, housepainters, operators of public dancing schools, florists, and private land surveyors could not be justified.¹ In Hawaii, the State Supreme Court ruled in 1935 that legislation requiring photographers to be licensed bore no reasonable relationship to public health, safety, or welfare and constituted an unconstitutional encroachment on the right of individuals to pursue an innocent profession.² The court held that mere interest in the practice of photography or in ensuring quality in professional photography did not justify the use of the State's licensing powers.

The public. The Sunset Law further states that for the exercise of the State's licensing powers to be justified, the potential harm must be to the health, safety, or welfare of that segment of the public consisting mainly of consumers of the services provided by the regulated occupation. The law makes it clear that the focus of protection should be the consuming public and not the regulated occupation or profession itself.

Consumers are all those who may be affected by the services provided by the regulated occupation. Consumers do not have to purchase the services directly. The provider of services may have a direct contractual relationship with a third party and not with the consumer, but the criterion is met if the provider's services ultimately flow to and adversely affect the consumer. For example, the services of an automobile mechanic working for a garage or for a U-drive establishment flow directly to the employer, but the mechanic's workmanship ultimately affects the consumer who brings a car in for repairs or who rents a car from the employer.

Consumer disadvantage. The exercise of the State's licensing powers is not warranted if the potential harm is one against which the consumers can reasonably be expected to protect themselves. Consumers are expected to be able to protect themselves unless they are at a disadvantage in selecting or dealing with the providers of services.

Consumer disadvantage can arise from a variety of circumstances. It may result from a characteristic of the consumer or from the nature of the occupation or profession being regulated. Age is an example of a consumer characteristic which may cause the consumer to be at a disadvantage. The highly technical and complex nature of an occupation is an illustration of occupational characteristic that may place the consumer at a disadvantage. Medicine and law fit into the latter illustration. Medicine and law were the first occupations to be licensed on the theory that the general public lacked sufficient knowledge about medicine and law to be able to make judgments about the relative competencies and about the quality of services provided to them by the doctors and lawyers of their choice.

However, unless otherwise indicated, consumers are generally assumed to be knowledgeable and able to make rational choices and to assess the quality of services being provided them.

Relationship between licensing and protection. Occupational licensing cannot be justified unless it reasonably protects the consumers from the identified potential harm. If the potential harm to the consumer is physical injury arising from possible lack of competence on the part of the provider of service, the licensing requirements must ensure the competence of the provider. If, on the other hand, the potential harm is the likelihood of fraud, the licensing requirements must be such as to minimize the opportunities for fraud.

Alternatives. Licensing may not be the most appropriate method for protecting consumers. Instead, prohibiting certain business practices, governmental inspection, or the inclusion of the occupation within another existing business regulatory statute may be preferable, appropriate, or more effective in protecting the consumers. Increasing the powers, duties, or role of the consumer protector is another possibility. For some programs, a nonregulatory approach may be appropriate, such as consumer education.

Benefit-costs. Even when all other criteria set forth in this framework are met, the exercise of the State's licensing powers may not be justified if the costs of doing so outweigh the benefits to be gained. The term "costs" in this regard means more than direct money outlays or expenditure for a licensing program. "Costs" include opportunity costs or all real resources used up by the licensing program; they include indirect, spillover, and secondary costs. Thus, the Sunset Law asserts that regulation which artificially increases the costs of goods and services to the consumer should be avoided; and regulation should not unreasonably restrict entry into professions and vocations by all qualified persons.

Chapter 2

BACKGROUND

Chapter 454, HRS, regulates the business of mortgage brokers and mortgage solicitors. No mortgage broker or solicitor can engage in business without being licensed by the state. This chapter explains what they do and the environment in which they operate.

The Mortgage Industry

An enduring American Dream has been to own a home. The problem, however, is that most people do not have sufficient cash to buy a home outright. So they look for financing, thus creating a need for a variety of financial services. This need has been filled by banks, savings and loan institutions, mortgage banking companies, and real estate firms. Today, people needing financial assistance turn to those who can offer it--the lenders--or to those who can help find the appropriate lenders--the brokers.

A mortgage can be defined as a "conveyance of an interest in property as security, for the repayment of money borrowed."¹ Home mortgage loans amount to significant sums. They totaled approximately \$442 *billion* nationwide in 1986. Shearson Lehman Mortgage Corporation, ranked eighteenth nationally, issued \$6.7 billion in mortgage loans in 1986.² It did \$63.5 million worth of business in Hawaii alone in the first eleven months of 1987. The number one firm in Hawaii, Weyerhauser Mortgage Company, issued \$147.6 million for the same time period.³

Mortgage loans are offered by a variety of institutions, including banks, savings institutions, credit unions, industrial loan companies, mortgage banking firms, and private financial service companies. Mortgage bankers make loans on residential and commercial real estate, package these loans, and sell in the secondary mortgage market to agencies such as the Federal Home Loan Mortgage Corporation or to investors.

Mortgage bankers may deal directly with customers or they may make loans through intermediaries, the mortgage brokers. They make money from points and loan fees charged in originating a mortgage loan. These are calculated according to a percentage of the loan, ranging from 1 percent to 2 percent.

Mortgage bankers also make money from servicing mortgage loans. This is the most profitable aspect of the business. It involves collecting principal and interest payments from the

homeowner for the mortgage holder. The mortgage servicer is paid a fee based on the outstanding principal. One major company, Shearson Lehman Mortgage, gets 85 percent of its revenues from loan servicing.⁴ Another company with offices in Hawaii estimates this bread-and-butter aspect of the industry accounts for 60 to 80 percent of its income.⁵

Mortgage brokers are intermediaries between mortgage lenders and those looking for financing. Brokers are brought in to assist consumers in their loan applications, get the necessary documentation, look for the best interest rates, bring the parties to settlement, and officially close the loan. They may also continue to service the loan afterwards for the borrower and lender until it is paid off. They collect and pay principal and interest payments, real estate taxes, and any other assessed charges. Mortgage brokers, in addition to helping with the loan application process, also follow up on delinquency problems, arrange foreclosure proceedings where necessary, keep records, communicate, and remit funds to the actual lenders.

Since the mid-1970's, consumers have become increasingly aware of the variety of options available to them. Double-digit interest rates, introduction of the adjustable rate mortgage with balloon payments, and deregulation, brought in new players, many of whom were mortgage brokers.

Changes in the industry. Mortgage brokers began to prosper when interest rates fell in 1986. Applications for new mortgages and refinancing jumped when home mortgage interest rates dropped to below 10 percent for the first time in a decade. This produced a mortgage surge that culminated in the "mortgage gridlock of 1987."⁶ Consumers flooded brokerage offices with multiple applications.

By 1987, the volume of mortgage loans in Hawaii rose 87 percent.⁷ There was a strong demand for increased services as consumers looked to new home purchases and the refinancing of equity in their homes. It is the demand for refinancing, valued at \$2 billion, that is providing a push for broker services today.⁸ Also, the Tax Reform Act of 1986, by limiting interest deductions on home mortgage loans while permitting interest deductions on home equity loans, has opened a new money market with "lenders who are eager to tap into the billions of dollars consumers hold in home equity."⁹

Institutional lenders, recognizing competitors got "better terms from a broker," are using brokers more because they "work out the negatives," contribute new funding sources, and bring new skills into the process as they expand into real estate.¹⁰

Occupational Characteristics

The occupation of mortgage brokers covers a wide range of characteristics. They play several roles: commercial mortgage brokers, agents for mortgage bankers, and mortgage brokers for borrowers.

As commercial mortgage brokers, they may create financing packages for sale to investors. Commercial mortgage brokers may take a development, create a financing package for the property, and present the package to a variety of lenders or investors.

As agents for institutional lenders, they will look for prospective borrowers for a fee.

As mortgage brokers for borrowers, they find or negotiate on behalf of homeowners who are looking for financing. In servicing their customers, they typically are able to offer a variety of loans from different companies and institutions and help the consumer to get a deal with better terms.

Mortgage brokers in Hawaii. There are 93 licensed mortgage brokers, 9 mortgage broker branch offices, and 386 mortgage solicitors in Hawaii as of February 11, 1988.¹¹ They serve those consumers who borrow money for any purpose in which a mortgage is involved, either as collateral, refinancing, or purchase. Out of a total of 46,137 conveyances in an 11-month period in 1987, 8,753 conveyances were handled by mortgage brokers and mortgage companies.¹² The mortgage brokerage business constitutes approximately 9 percent of all mortgages recorded. The average loan is \$81,000, a substantial increase in value per mortgage over the past few years.

Regulation of mortgage brokers. Consumer complaints about the industry have resulted in increased federal and state regulation. Complaints have ranged from non-delivery of promised loan rates, false advertising, inability to arrange for financing on schedule, and undisclosed points. The intensity and number of consumer complaints have led to a strong responsive trend to expand federal and state regulation and to provide legal assistance to the consumer.

There has been recent interest in regulation at the federal level. At the state level, 24 states have begun to regulate mortgage brokers within the past two years as a result of consumer complaints.¹³ The thrust of the new legislation has been to regulate more closely the activities of mortgage brokers by requiring them to be licensed and by specifying certain loan commitment procedures.

Federal regulation. A recent study of mortgage brokers by the Congressional Research Service found that there is no comprehensive scheme for federal regulation of mortgage brokers and no primary federal agency responsible for oversight of the industry.¹⁴ However, several federal agencies claim some jurisdiction under a variety of laws and regulations: the Federal Reserve System, Federal Home Loan Bank Board (FHLBB), the Federal Trade Commission (FTC), and the Department of Housing and Urban Development (HUD).

Real Estate Settlement Procedures Act (RESPA). Lending institutions are regulated by the federal government under RESPA, which is administered by the Federal Reserve Board, the FHLBB, the FTC's Bureau of Consumer Protection, and HUD.

RESPA requires lenders to provide a uniform settlement disclosure sheet. Mortgage brokers must comply with RESPA requirements for disclosure of closing costs and prohibitions against referral fees or kickbacks if they are involved in loans insured by the federal government and packaged to be sold in the secondary markets.

However, RESPA's prohibition against referral fees (kickbacks) between lenders and servicers, like real estate and mortgage brokers, has been confused by a recent case (U.S. v. Graham Mortgage Corporation) which held that mortgage loan "referrals" are not covered by RESPA antikickback sections.¹⁵ A major bank program was recently exempted from compliance with RESPA by allowing the bank (the lender) to pay others, among whom are real estate and mortgage brokers, for "fast-track" application processing and low points.

FHLBB and FTC. The FHLBB is recognized as having some enforceable power over state law at this time with respect to lender and borrower relations. They enforce usury restrictions on interest rates, due-on-sale clauses, RESPA's requirements for disclosure under Regulation Z, the Equal Credit Opportunity Act, and the Truth-in-Lending Act. They are able to do this either by express authority or by their own regulating which has allowed them to occupy the field.

Mortgage brokers are not lenders usually and consequently, have a tenuous relationship with these stricter federal protections. However, because they are involved in consumer credit transactions, they appear to be subject to several federal requirements. A congressional report claims they are subject to the Truth-in-Lending Act and Federal Reserve System regulations requiring disclosure, conditions for charges, and annual percentage rates.

The FTC held, as far back as 1976, that fees paid to mortgage brokers were a "finance charge" within the scope of section 226.4(a)(3) of Regulation Z, and had to be revealed. However, the FTC was reversed by Congress in 1982, when the Garn Act (Garn-St. Germain Depository Institutions Act of 1982) "relieved" mortgage brokers from having to comply with the Truth-in-Lending Act and Regulation Z, except if the broker lends his or her own funds.

The Truth-in-Lending Act enforced by the Federal Home Loan Bank Board, with its accompanying Regulation Z, is designed to insure that prospective borrowers and purchasers receive credit cost information *before* entering into a transaction. Its requirement for annual percentage rate disclosure is also considered "broadly permissive" by consumer advocate groups when changes occur at closing.¹⁶

Congressional interest. Congress has been looking into the problem further. A General Accounting Office (GAO) report to the Congress on new mortgage instruments found that consumers have the same problems with mortgage brokers that they have with institutional lenders. GAO recommended complete disclosure and choice of mortgage instruments for consumers facing increased risk.

Congress took a brief look at mortgage brokers in early 1987. It concluded some federal agencies had jurisdiction and some states were attempting a variety of legislative solutions, but brokers were “largely uncovered by comprehensive regulation, either state or federal.”¹⁷

Congress took a small step in May 1988 by passing H.R. 3011, a Home-Equity Lenders bill. Consumer groups added a provision that would prohibit lenders from unilaterally changing any contract terms in secondary mortgage or home equity loans, a line of credit secured by the borrower’s home. This provision was directed at problems in the new refinancing market that brokers have rushed into in recent years, particularly the problem of mortgage brokers who unilaterally raise interest rates at closing.

State regulation. States have been tightening up their regulations of mortgage brokers. However, they are described as a “crazy quilt pattern of laws and opinions.”¹⁸ There is no widespread regulation of the mortgage industry as such. They are regulated under usury laws, laws regulating interest rates, privacy regulation, consumer protection statutes, or licensing laws.

Many states have recently passed legislation in response to the problem where consumers have failed to receive the originally committed interest rate. Maryland ordered its 322 licensed mortgage brokers and lenders to “either give the original rate offered to borrowers or face stiff penalties.”¹⁹ Illinois passed The Residential Mortgage Act of 1987 to protect consumers and to place residential mortgage lenders under appropriate regulatory scrutiny.

Regulation in Hawaii. Consumer complaints appear to have been the impetus for licensing mortgage brokers in Hawaii in 1967. The Senate Committee on Ways and Means stated that testimony had indicated that there were abuses stemming from “fly-by-night operators who promise to secure mortgage loans financing, usually charge excessive fees, and often fail to produce results and disappear with advance fees paid.”²⁰

The new law, Chapter 454, defined mortgage broker and solicitor and required them to be licensed, designated the Director of Regulatory Agencies as “Commissioner”, required a licensing bond of \$15,000, annual renewal and transfer fees, and a two-year suspension of license or revocation for noncompliance or misdeeds, with power of injunctive relief for the state. The law exempted most institutional lenders, brokers, attorneys, and real estate brokers because of oversight by other federal and state laws.

Only minor changes have been made in the law since then except for an amendment in 1973 which expanded the scope of the law. The 1973 amendment was the direct result of the bankruptcy of a local firm, Pan American Finance Corporation. It had filed for reorganization under bankruptcy laws, leaving 1,500 to 2,000 local investors caught in the middle, with claims of \$16 million.²¹

The amendment added new provisions to Chapter 454 to protect *investors* in mortgage loans. Prior to this, the law regulated the relationship between mortgage brokers and borrowers seeking mortgage loans. Now, regulation was expanded to govern the relationship between mortgage brokers and lenders or investors. The amendment sought to limit the extent of losses for investors by restricting the number of persons a broker could transact business with within a year. It limited mortgage brokers to selling or negotiating loans to no more than 25 persons during a 12-month period.

In 1983, amendments were made to delete a U.S. citizenship requirement and to require business registration and branch office solicitor designations.

Current regulation. Under Chapter 454, it is illegal for anyone to act as a mortgage broker or mortgage solicitor without a license. A mortgage broker is defined as a person who either directly or indirectly makes, negotiates, acquires, or sells or offers to make, negotiate, acquire, or sell a mortgage loan but excluding the sale of notes or bonds secured by mortgages that would be subject to registration under the State's Uniform Securities Act.

A mortgage solicitor is an individual who performs any of the functions of a mortgage broker who is employed by a mortgage broker or who works under the direction, control, or management of a mortgage broker.

Among those exempted from Chapter 454 are banks, trust companies, building and loan associations, pension trusts, credit unions, insurance companies, industrial loan companies, those making mortgages with their own funds without any intention to resell, or persons who negotiate loans but whose principal businesses are law and real estate.

To be licensed as a mortgage broker, applicants must be 18 years or older, submit a written application with a \$15,000 surety bond, provide a notarized experience statement, photograph, and pay a \$100 annual broker license fee (\$25 for solicitors). They must display their license in an office and maintain a principal place of business in the State. Mortgage brokers cannot negotiate or sell loans to more than 25 persons, other than institutional investors, within a calendar year.

The Director of the Department of Commerce and Consumer Affairs is designated the Mortgage Commissioner. Powers of the Commissioner include the right to investigate and examine records of brokers for any violations of the law.

A broker's license may be suspended for making false promises, misrepresentation, failure to disburse funds appropriately, account for money or property properly, or failure to put funds into escrow accounts. Licenses may also be revoked for misrepresentation and negligence or incompetence. The commissioner also has discretionary power to enjoin a broker from continuing business. Penalties for violation of the statute are a fine of not more than \$1,000 or one year's imprisonment, or both.

Rules to implement Chapter 454, were enacted in 1980 but repealed in 1985 when agencies were instructed to re-order rule-making procedures. Currently, there are no rules.

Chapter 3

EVALUATION OF THE REGULATION OF MORTGAGE BROKERS AND SOLICITORS

In this chapter, we assess the need for regulation based on the potential for consumers to be harmed by mortgage brokers. We also evaluate the adequacy of Chapter 454, HRS, in protecting the public and the regulatory operations under the Department of Commerce and Consumer Affairs (DCCA) and make recommendations for improvement.

Summary of Findings

We find that:

1. There is a need for regulation because of serious economic losses suffered by consumers. In fact, the potential for harm is increasing because of changes in the mortgage industry and the absence of any consistent regulation nationwide.
2. Regulation of mortgage brokers is weak because of the lack of clarity in the current statute, the overlap between Chapter 454 and Chapter 454D which regulates mortgage and collection servicing agents, the absence of provisions that would reduce misunderstanding and conflict between brokers and consumers, and the inappropriate placement of the program in DCCA's Professional and Vocational Licensing Division.
3. The DCCA has not adopted rules for the program. Consequently, there are no guidelines for evaluating applicants for licensure and the law is not being enforced forcefully.

Need for Regulation

The regulation of mortgage brokers and solicitors was designed to prevent fraud, deceit, or misrepresentation about loan processing, interest rates, and incompetent service. Examples of all three kinds of problems are well documented nationwide and in Hawaii. It is said that a consumer movement is under way in home mortgage financing because of problems with lenders and brokers. Consumer complaints about mortgage brokers fall in several areas, primarily:

- . failing to deliver the loan at the original interest rate;
- . collecting application and loan fees before the loan is closed;
- . false advertising and misrepresentation; and
- . kickbacks or costly referral fees.

Lock-in rates. Federal and state regulators have received thousands of complaints about interest rate problems in the past two years. Mortgage brokers quote a low interest rate or promise to lock-in an interest rate for a specified period but then fail to close the deal at the quoted rate. Brokers often charge additional fees for locking in interest rates for a specified period of time. Applicants pay these fees and then find delays in loan processing so that by the time they close the loan, the lock-in period has expired. They then find that they must either go along with a higher interest rate or lose all their application fees.

Brokers blame the processing delays on the glut of mortgage and refinancing applications. They say that they have no control over many aspects of the application process and that the vast majority of delays are due to backlogged appraisals, credit reports, termite inspections, and property surveys. However, borrowers claim that lenders deliberately drag their feet until interest rates rise or the lock-in period has expired.

A former mortgage loan originator testified at a hearing on mortgage credit issues before the Senate Subcommittee on Housing and Community Development that when the rate was to be set at the time of commitment, the final approval was deliberately delayed to coincide with a rate increase.¹

The Consumer Federation of America, Consumers Union, and Public Citizen have testified that a typical scenario is a lender who assures a borrower that it has loans at competitive rates. The borrower assumes that the quoted terms will remain fixed through settlement. When the settlement date arrives, the lender's representative suddenly informs the borrower that the points and/or the interest rate has increased. Faced with the alternative of losing the property, the borrower--all too frequently--agrees to the new terms.²

The Maryland State Bank Commissioner and the Commissioner of Consumer Credit received over 800 written complaints from prospective home buyers in 1986. Typically, the complaints charged that delays in loan processing resulted in the expiration of a 60-day commitment by the lender to honor a quoted interest rate.

One complainant stated that when the commitment period expired on the 9 1/2 percent loan, she was offered three new rates which would cost her \$11,000 to \$18,000 more over the life of the 30 year loan. Her up-front points were also increased from an additional \$1,300 to \$5,000.³

The Maryland Bank Commissioner informed all licensees that prospective buyers must be provided with a written agreement signed by the broker which discloses all material aspects of the mortgage provider's obligations. The borrower must be told in writing if interest rates are locked in for a particular period of time. The borrower must also be informed in writing of the

borrower's obligations to supply the necessary documentation, any contingency that may delay the closing of the loan, and any foreseeable circumstance that would allow the broker to change any of the terms of the agreement.⁴

Loan fees. New Jersey's Department of Banking reported receiving 1,400 written complaints from potential borrowers asserting that they had been mistreated or defrauded. One firm closed shop without obtaining loans for people from whom it had collected thousands of dollars in fees. One applicant complained that he had paid a \$300 processing fee, plus \$5,400 in points, \$3,600 for a lock-in agreement, and \$1,800 as a "good faith" deposit. After waiting several months, he had to get another loan on his own.⁵

The department subsequently developed new regulations to protect borrowers in the application process that would prohibit lenders from collecting application and loan fees before closing and would require them to refund fees under certain specific circumstances if the loan is not consummated.

False advertising and misrepresentation. Brokers have been accused of bait-and-switch schemes where they advertise low interest rates but fail to deliver the loan at that rate.

They have particularly harmed consumers in the home equity or second mortgage market by offering attractive home equity loans that could prove to be economically devastating if interest rates climb or a borrower's income declines. Often these loans are made to individuals without clear consideration of their ability to repay. No credit checks or appraisals are made. They may promise low monthly payments but add a balloon payment at the end which is not clearly explained to the borrower. The likely consequence is costly refinancing or risk of foreclosure.

An illustration is given of a Phoenix construction worker who took out a second mortgage for \$7,600. The loan carried an interest rate of 20 percent but the actual rate was 32.43 percent including finance charges and brokers' fees. After six years, the worker had paid \$21,000, refinanced the loan twice to meet balloon payment but found that he had another \$21,000 balloon payment due on the loan.⁶

Borrowers have also complained that brokers have not disclosed or represented themselves clearly. Part of the reason for the thousands of complaints received by the New Jersey Department of Banking was due to the failure of brokers to clearly disclose to borrowers their function in the loan application process. Borrowers were led to believe they were dealing with a mortgage banker when they were speaking to a third party who was only brokering the loan and not making it.⁷

There are also consumer complaints that brokers fail to disclose all charges ahead of time, such as points, and whether the charges are refundable.

Several states have begun to require brokers to make more written disclosures to borrowers. For example, the new regulations issued by New York require brokers to fully disclose their function in the loan application process and to state explicitly that they are brokering the loan, not making it.⁸

Kickbacks. Referral fees and kickbacks are considered particularly injurious to consumers. In the past two years, lenders have been offering brokers such inducements as Caribbean vacations and cash payments to steer new customers in their direction. Some lenders have offered as much as half a percentage point in cash to brokers in an aggressive effort to increase their share of new mortgages.⁹

In these situation, borrowers are led to believe that the broker is acting on their behalf and shopping for the best terms for them when the broker may be steering the borrower to a high cost lender who has provided the broker with referral fees.

As noted earlier in Chapter 2, kickbacks to mortgage brokers are no longer considered illegal under the federal Real Estate Settlement Procedures Act. Some states are responding to this situation by requiring brokers to disclose whether they receive any fees from lenders and which lenders they do business with primarily.

Harm in Hawaii. Hawaii has not escaped these problems. Consumer complaints document similar problems at the State's Regulated Industries Complaints Office (RICO). They provide further evidence of the need for regulation. A review of consumer charges filed with RICO since 1980 have alleged:

- failure to service accounts before a lock-in rate expired;
- deliberate lying and delays to charge a higher interest rate than originally quoted and promised;
- misrepresentation (Bait-and-switch);
- false promises;
- failure to disburse funds and create escrow accounts;
- withholding of refundable monies; and
- gross negligence.

There were 122 complaints filed with RICO during the period 1980-1987. Almost half of these cases were closed and settled or closed with no violation. These, for the most part, were complaints that the brokers had withheld application fees. When the brokers returned the fees to the consumer, the matter was dropped.

Six cases involved one mortgage broker whose purpose was to "bait" the consumer into putting up application deposits and never doing anything to secure the loan. These cases were

settled in favor of the consumers with a temporary restraining order, permanent injunction, and full refunds. The broker received a \$5,000 fine. Another complaint involved a broker with a history of five past complaints who appeared to take application fees from consumers known to be unqualifiable.

Nine were referred for civil litigation on a variety of grounds from false promises to failure to disburse funds, misrepresentation, and failure to have a license or principal place of business in the state.

In a case reported in the news, one developer reported that he had paid a \$3,000 fee up front and other expenses and never got a promised commitment letter from the broker. Another developer who hoped to get a loan of \$27.5 million reported he was bilked of more than \$800,000.¹⁰

Complaints appear to be increasing. RICO files show 45 cases were filed in 1987, the most in one year. Twenty-two cases were filed in 1986, the year of the mortgage gridlock.

Increasing potential for harm. Changes in the mortgage broker industry may increase the potential for harm. An increasing number and variety of large companies are moving into the business. They are creating an unstable business environment where business fluctuates with interest rates.

Brokered loans have been recognized as “one of the major trends in the 1980s.” The lucrative loan servicing aspect of the mortgage broker is undergoing a consolidation shift of nationwide proportions. It is widely acknowledged by industry analysts that a “shake-out and consolidation” of roles is under way, as large financial service groups buy up smaller mortgage companies.¹¹

Major corporations, like Sears, General Motors, Ford, Prudential and others, are moving into mortgage lending. In conjunction with a perceived public demand for one-stop shopping, real estate firms are getting into the business of raising money to finance their own projects. Real estate brokers are moving aggressively into the intermediary role in the loan origination process as a natural extension of their relationship with sellers and buyers.¹²

Banks around the country are also trying to engage in real estate, acknowledging they need expanded services to compete with other financial service companies. And credit unions can now offer better rate mortgages by eliminating mortgage broker commissions.

Besides consolidation and blurring of the real estate and financial service industries, the mortgage broker industry fluctuates with interest rates. Mortgage brokers proliferate with decreasing interest rates but diminish in numbers as rates increase and the market dries up. Industry players feel that eventually it will be the “good practitioners, those that have approached mortgage lending on a sound basis, that will continue.”¹³

As pointed out in Chapter 2, there is as yet no comprehensive federal law governing the activities of mortgage brokers. Several federal agencies claim tangential jurisdiction over certain specific activities of mortgage brokers under different laws. Forecasters predict increased government intervention (possibly even the creation of a Uniform Mortgage Banker Act) in financial service industries. However, until that occurs, the changes in the industry will create increased instability and competition without any corresponding increase in protection for consumers. In view of this situation and the evidence of consumer harm, we believe that regulation of mortgage brokers should be continued.

Law Needs to be Clarified and Strengthened

Chapter 454 should be retained. However, changes are needed to clarify regulation in the following areas:

- The scope of the law should be clarified to exclude sales made by brokers to investors or lending institutions;
- Chapter 454 overlaps with Chapter 454D which regulates mortgage and collection servicing agents, thereby subjecting mortgage brokers to two laws with inconsistent requirements;
- Requirements for disclosure and the use of an “honor agreement” between brokers and customers would help to reduce misunderstanding and conflict; and
- The placement of the program in DCCA’s Division of Professional and Vocational Licensing is inappropriate and has led to weak implementation and enforcement of the program.

Clarify scope of law. As enacted in 1967, the law was clearly directed at the relationship between mortgage brokers and borrowers looking for mortgage loans on real property. It sought to prevent such abuses as fly-by-night operators who promise to secure mortgage loan financing but charge excessive fees and disappear with the fees.

The scope of the law became confused when it was expanded to cover investors. In 1972, a local company, Pan American Financial Corporation, went into bankruptcy owing mortgage loan investors \$16 million. As was the custom for mortgage brokers, the company had its name listed as the “mortgagee” or held an interest in title to the property underwritten by the investors. When the brokerage company went under, it pulled its investors with it.

To prevent such problems, the legislature expanded the law to cover investors by enacting an amendment restricting the selling of mortgage loans. Section 454-3.5 now prohibits the sale or negotiation of more than 25 loans within any 12 consecutive months by brokers to individuals

but allows such transactions to institutional investors. At the same time, the law was amended to exclude transactions that would fall under the State's Uniform Securities Act.

The amendment does little to protect consumers, it confuses the scope of the law, and it is unenforceable.

Generally, investors are already protected under the State's Uniform Securities Act and general tort laws. The sale of notes or securities secured by mortgages are subject to registration under the State's Uniform Securities Law, Chapter 485. Companies that sell investors mortgage notes of questionable value are generally prosecuted for securities fraud and not under laws regulating mortgage brokers. Furthermore, sanctions in Chapter 454 are inadequate for this purpose. They consist merely of not more than a \$1,000 fine and imprisonment of not more than one year, or both. In addition to the Uniform Securities Act, general civil and criminal statutes would protect consumers from such acts as deceit, malpractice, negligence, any wrongful act, unfair and deceptive practices, and theft.

The amendment restricting mortgage brokers to 25 transactions is clearly restrictive and serves no consumer protection function. In addition, the department reports that the 25-transaction restriction is unenforceable. They have no way of determining how many transactions brokers make nor do they attempt to do so.

The amendment restricting the number of sales should be repealed and the definition of mortgage broker changed to make it clear that it is the broker's relationship to the borrower than is being regulated, not the the broker's relationship to the lender or investor.

Duplication in regulatory statutes. Currently, mortgage brokers who provide mortgage servicing functions are regulated under both Chapter 454 and Chapter 454D. Chapter 454D regulates mortgage and collection servicing agents. It defines a mortgage servicing agent as someone who undertakes to collect for another person the amounts due under any agreement which provides for installment payments and which is secured by an interest in real property, including mortgage loans. Mortgage brokers perform the same services as mortgage collection agents in their servicing function; therefore, they are subject also to Chapter 454D.

As mortgage brokers who may also provide mortgage servicing functions, brokers must be licensed under Chapter 454 and post a bond of \$15,000. As mortgage servicing agents, brokers must also register under Chapter 454D and post a \$50,000 bond or irrevocable letter of credit in the same amount.

The dual regulation of mortgage brokers has been confusing, even to DCCA. Generally, complaints relating to mortgage servicing agents are logged under the mortgage brokers program. This is because the laws governing their activities as brokers have more substance than the laws governing them as mortgage servicing agents.

Since they are already regulated by Chapter 454, it is not necessary to also regulate them under Chapter 454D. In our sunset evaluation of mortgage and collection servicing agents, we are recommending that mortgage brokers be exempted from Chapter 454D.

Need for disclosure and an honor agreement. Many of the complaints made by borrowers stem from the lack of proper, written disclosure about the loan process, the fees that will be required, the documents needed, and other aspects of the process. Consumers have complained particularly vociferously, both nationwide and in Hawaii, about loan fees and the breaking of locked-in interest rate agreements. They say that brokers have consistently broken that commitment in order to slide in higher interest rates at the last moment.

The industry complains that consumers bring this on themselves by their delays in getting together the necessary documentation and that they are guilty of filing multiple applications.

Consumers and brokers both deny they are part of the problem. There is need for new guidelines upon which consumers and mortgage brokers can agree. Each is responsible for their part in this loan process. Many times, a lack of communication and a tendency to take things for granted can result in mistrust and accusations of bad faith.

Honor agreements. An honor agreement which delineates the responsibilities of both consumers and brokers could cut down on delays and a source of disagreement. Consumers should have clear guidelines on their role in the process. For example, most consumers know they must have certain documents, for example, to get a car registered. Likewise, it would be reasonable to require, not just expect, them to bring specific documents to a first loan meeting.

Requirements for brokers should also be established. Four Northeastern states (Massachusetts, New Hampshire, Connecticut and Maine) quickly required the honoring of “lock-in” agreements during the 1986 lending surge.¹⁴ Connecticut now requires a written agreement between the lender or a representative (like a mortgage broker) mandating a lock-in period for as long as the good faith estimate of the loan process time. If violated by the lender, all fees are to be refunded, the commitment *must* be extended, and losses absorbed.¹⁵ Maine issued a “Delayed Mortgage Closing” Bulletin in 1986 having the force and effect of law. It told lenders and their representatives that if interest rate lock-in commitments were violated, they would be charged under the State’s Unfair Trade Practice Act, a more powerful statute than the licensing one.¹⁶

Brokers should also be required to disclose in writing any referral fees that they receive from lenders, the terms and conditions of the loan, the types of fees to be charged and whether they are refundable, the closing costs, and monthly payment plans. In effect, what is needed is an

honor agreement between the broker and the buyer clearly stating respective responsibilities, what each side agrees to do to ensure a successful loan process, and what reparation each will pay if the agreement is broken.

Current placement inappropriate. The State's ability to protect consumers depends in large part upon an effective and efficient enforcement program which is headed by a properly trained regulator. We believe it would be more appropriate to place the program under the DCCA's Commissioner of Financial Institutions (CFI) instead of the Professional and Vocational Licensing Division.

The CFI has the authority under Chapter 401 to oversee all financial institutions. It currently oversees the activities of banks, trust companies, building and loan associations, industrial loan and investment companies, and fiduciary companies, including escrow depositories.

The CFI, among other functions, is empowered to examine the actions of an institution's officers and directors with respect to funds entrusted to it in any fiduciary capacity, the prudence of its management, the adequacy of its assets, its manner of transacting business, the security afforded to those who deal with the institution, and whether the institution is in compliance with state law.

The CFI has more expertise and knowledge of the workings of financial institutions and the secondary mortgage market. It would be able to keep up with changes in the industry and what corresponding changes would be needed in regulating mortgage brokers. It has higher standards, a larger, more knowledgeable staff, and deals directly with financial matters.

Almost half the states now regulating mortgage lenders and brokers have assigned the regulatory responsibility to their banking or securities divisions, financial institution departments, or savings and loan commissioners.

Weak Regulatory Program

Lack of rules. The Director of DCCA is designated the mortgage commissioner with responsibility for implementing the regulatory program. The administration of the program has been weak, partly because the department has no current rules for the program. Administrative rules were adopted, but later repealed in 1985. The lack of rules makes it difficult for the department to process applications properly or to deny, revoke, or suspend licenses.

There are no guidelines to implement the requirement that applicants be assessed on their experience, integrity, and competency as to financial transactions involving mortgage financing. There are also no guidelines relating to advertising, solicitation, forms and procedures used in making loans, and fees or commissions charged. The weakness of the current regulatory program

under the Professional and Vocational Licensing Division makes a stronger case for moving the jurisdiction of mortgage brokers and solicitors to the Commissioner of Financial Institutions.

Experience. Section 454-3(d) states that the Commissioner shall require information as to the “experience, integrity, and competency of the applicant as to financial transactions involving primary or subordinate mortgage financing.” Applicants for licensure as mortgage brokers or mortgage solicitors are asked to state their experience in handling financial transactions involving mortgage financing or related experience.

However, there are no rules outlining minimum qualifications or what would be considered acceptable experience. Without rules, there are no standards and no guidelines for determining if applicants indeed qualify for licensure.

It is also confusing for applicants because the DCCA application forms contain only minimal information for applicants. Applicants are asked to describe in detail their experience in “financial transactions involving primary or subordinate mortgage financing.” However, the words are not explained. Without a clear definition of these critical terms, licensees would have a hard time seeing if their diverse work experience meets statutory guidelines. What one applicant might consider pertinent and relevant financial experience might mean something entirely different to another, or it might be irrelevant with regard to actual requirements.

A review of mortgage broker applications, at random, shows a range from detailed work descriptions and knowledge of law to mere recitations of prior employers and positions. Some corporations merely filed incorporation papers in lieu of detailed experience. Responses on mortgage solicitor applications were even more vague, from nothing, or mere job titles, to some clear work experience descriptions.

Applicants are also asked to submit a form to be filled out by previous employers verifying their experience in financial transactions involving mortgage loans. Here again, there are no guidelines for assessing the information received or for determining the validity of the experience information. Since 1980, only one license has been denied because a mortgage broker applicant misrepresented an experience qualification (claiming to have a real estate license), which turned out to be false. The applicant was later approved as a mortgage solicitor.

The department should determine what kind of experience is appropriate to protect the public. Rules can then be adopted to establish criteria for the experience requirement to assist applicants and those responsible for reviewing applications.

Lack of enforcement. The absence of rules has also made it difficult for DCCA to properly enforce the law. Enforcement has been weak in the areas of advertising, solicitations and fees, bonding, and forfeiture of licenses.

Advertising, solicitations and fees. The department has the authority to issue rules regarding advertising, solicitation, loan forms and procedures, and fees and commissions charged. This power has the potential to address consumer complaints about misrepresentation, “bait-and-switch,” false advertising, and deliberate delays to incur higher interest rates. Effective rules would enable DCCA to present reasonably fair business guidelines to the industry and to enforce deviations from these practices.

Forfeiture and sanctions. The law states there will be an “automatic forfeiture” of the license for nonpayment of renewal fees. Licenses can be restored if reapplication is made within six months and a penalty fee of \$100 paid for a broker’s license and \$25 paid for a solicitor’s license. This means that any licenses expired as of December 31, 1987, and not renewed as of July 1, 1988, should be put into the forfeit category. These brokers and solicitors must then go through a new application process.

As of July 1, 1988, there were 97 mortgage solicitors and 34 mortgage brokers with expired licenses. Their status is uncertain because there is a processing backlog at DCCA. According to the department, no letter is sent out by DCCA advising brokers or solicitors that their licenses are forfeited and that under law they must stop doing business. Nor are they stopped from doing business within a reasonable time.

Under the current system, it is not clear which brokers are legitimate and should be allowed to continue doing business because of DCCA’s backlog, and which are truly forfeit. It also means that important information about the status of a mortgage broker or solicitor is not available to the consumer.

Chapter 454-8 states, “Any contract entered into by any person with any unlicensed mortgage broker or solicitor shall be void and unenforceable.” This means that legally, during the forfeit problem cited above, for whatever reason, all contracts which non-licensed brokers have with consumers are unenforceable. Most consumers are unaware of this section and it has not been enforced by the state at any time.

Recommendations

We recommend that:

1. *Chapter 454, Hawaii Revised Statutes, be reenacted. In reenacting Chapter 454, the legislature should consider making the following amendments:*

- *Clarify that the regulation of mortgage brokers covers the brokers’ activities in relationship to borrowers and not to investors.*
- *Delete the provision restricting brokers to no more than 25 transactions a year.*

- *Place responsibility for the program with the Commissioner of Financial Institutions.*
 - *Require brokers to prepare an "Honor Agreement" identifying the respective responsibilities of borrowers and brokers and disclosing all fees to be incurred during the loan process and whether they are refundable, the closing costs, and any referral fees received by the broker.*
2. *The Department of Commerce and Consumer Affairs adopt rules which include provisions covering the license approval process; advertising, solicitations, and fees; voidable contracts; and publication of the names of those with expired, revoked, or suspended licenses.*

NOTES

Chapter 1

1. See discussion in *51 American Jurisprudence*, 2d., "Licenses and Permits," Sec. 14.
2. *Terr. v. Fritz Kraft*, 33 Haw. 397.

Chapter 2

1. *The Random House Dictionary of the English Language*, New York, Random House, 1987, p. 265.
2. "Shearson Lehman Mortgage Chief Continues Making Hay While Waiting Till the Sun Shines," *Los Angeles Times*, November 25, 1987.
3. *Monthly Mortgage Barometer for the Hawaiian Islands*, Title Guarantee of Hawaii, Inc., November 30, 1987.
4. "Sherson Lehman Mortgage Chief Continues Making Hay."
5. "A Mortgage Banking Giant from Rhode Island," *American Banker*, December 1, 1986.
6. Mike Rosser, "Weathering the Wave of Legislative Change," *Mortgage Banking*, October 1987, p. 133.
7. Interview with Ron Schmid, President, Honolulu Mortgage Company, July 9, 1988.
8. "Money Store's New Market," *Real Estate Finance Today*, March 20, 1987, p. 25.
9. "Consumer Problems in the Mortgage Market," Testimony jointly submitted by Consumer Federation of America, Consumers Union, and Public Citizen to the Senate Banking Committee, Hearings held January 23, 1987.
10. "Mortgage Brokers Form a Useful Tool in Mortgage Sales," *Savings Institute*, Vol. 107, October 1986, p. 172.
11. Hawaii, Department of Commerce and Consumer Affairs, "Summary Geographic Report," February 11, 1988, p. 17-18.

12. *Monthly Mortgage Barometer for the Hawaiian Islands.*
13. A. L. Negroni, "Traps for the Unwary: Recent Legal Development in Mortgage Banking," *Mortgage Banking*, Vol. 48, No. 1, October 1987, p. 166.
14. M. Maureen Murphy, *Regulation of Mortgage Broker Industry*, Washington, D. C., Congressional Research Service, Library of Congress, February 18, 1987.
15. "Mortgage Fees Cause Federal Right," *Washington Post*, January 30, 1988, p. E7.
16. "Consumer Problems in the Mortgage Market," Testimony jointly submitted by Consumer Federation of America, Consumers Union, and Public Citizen to the Senate Banking Committee, Hearings held January 23, 1987.
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18. Mike Rosser, "Weathering the Wave of Legislative Change." *Mortgage Banking*, October 1987, p. 193.
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20. Senate Standing Committee Report 897 on House Bill No. 32, Fourth Legislature, 1967
21. "Pan Am Financial in Trouble, *Honolulu Star-Bulletin*, July 19, 1973, p. D 1, 3.

Chapter 3

1. Hearing before the Senate Subcommittees on Housing and Community Development, *Mortgage Foreclosures and Other Current Mortgage Credit Issues*, July 23, 1986, Washington, D.C., Government Printing Office, p. 52.
2. "Consumer Problems in the Mortgage Market" Joint Testimony by the Consumer Federation of America, Consumers Union, and Public Citizen to the Senate Banking Committee, hearings held on January 23, 1987.
3. "Maryland Lenders Warned on Commitments," *Washington Post*, July 5, 1986, p. E2.
4. Letter to Licensees from Marcia H. Muller, Bank Commissioner, State of Maryland, April 22, 1987.
5. Denise M. Topolnicki, "Home Loan Horrors," *Money*, August 1987, pp. 69-85.

6. Denise M. Topolnicki, "Home Loan Horrors," *Money*, August 1987, p. 85.
7. "Increase in Mortgage Fees Set," *New York Times*, July 26, 1987, p. 8.
8. Andrea Less Negroni, "Traps for the Unwary," *Mortgage Banking*, October 1987, p. 166-178.
9. "Mortgage Fees Cause Federal Fight,:" *Washington Post*, January 30, 1988, p. E7.
10. "Loan Brokers: Risky Business," *Pacific Business News*, May 12, 1986.
11. T. Ferris, "A Mortgage Banking Giant from Rhode Island," *American Banker*, December 11, 1986, p. 1.
12. M. McFall, "Outdo Your Competition," *Mortgage Banking*, December 1986, p. 67.
13. M. Basch, "Not Just Retirees, but Also Yuppies That Flock to Florida," *American Banker*, October 9, 1987, p. 23.
14. "Time to Refinance Your Mortgage?" *Consumer Reports*, October 1986, p. 649.
15. Telephone interview with Roger La Bonte, Connecticut Banking Commission, July 15, 1988.
16. "Telephone interview with Leon Merrill, New Hampshire State Banking Department, July 18, 1988.

APPENDICES

APPENDIX A

COMMENTS ON AGENCY RESPONSE

A preliminary copy of this Sunset Evaluation Report was transmitted on October 21, 1988 to the Department of Commerce and Consumer Affairs for its review and comments. A copy of the transmittal letter to the department is included as Attachment 1 of this Appendix. The response from the department is included as Attachment 2.

In the same letter, the department responded to both our *Sunset Evaluation Report on Mortgage and Collection Servicing Agents* and our *Sunset Evaluation Report on Mortgage Brokers and Solicitors*. Here we comment on the department's response to Chapter 454 on the *regulation of mortgage brokers and solicitors*.

The department agrees with our recommendations to reenact Chapter 454 to provide for continued regulation of mortgage brokers and solicitors. It also agrees with our recommendation to amend the definition of mortgage brokers to cover the broker's activities in relationship to borrowers, to delete the restriction of no more than 25 transactions a year, and to require an "Honor Agreement" identifying the respective responsibilities of borrowers and the mortgage brokers.

The department "will not dispute the rationale" that mortgage bankers should be exempt from Chapter 454D since they are already regulated under Chapter 454. However, the department is concerned that the bonding requirement for mortgage brokers under Chapter 454 would be only \$15,000 instead of the \$50,000 they are now subject to under Chapter 454D.

The department says that we made no recommendation on what the bond amount should be for mortgage brokers under Chapter 454. We do not believe that a change in the bond amount in Chapter 454 is needed. In addition, we had raised the question of the appropriate amount of bonding in some recent sunset evaluation reports and the department had responded that it was reviewing the issue of bonding generally. If the department finds in its overall review of bonding that an increase is warranted it should recommend an amendment to the statute to the Legislature.

The department is also concerned with transferring the regulatory program to the Commissioner of Financial Institutions saying that the Commissioner lacks the resources necessary to implement the program. It says that considerable time, effort, and adequate training of staff will be necessary to make the program fully enforceable. We suggest that the department present its needs to the Legislature for its decision on the appropriate level of resources for the program.

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
465 S. KING STREET, RM. 500
HONOLULU, HAWAII 96813



ATTACHMENT 1

CLINTON T. TANIMURA
AUDITOR

October 21, 1988

COPY

Mr. Robert A. Alm, Director
Department of Commerce and Consumer Affairs
State of Hawaii
1010 Richards Street
Honolulu, Hawaii 96813

Dear Mr. Alm:

Enclosed are three preliminary copies, numbered 4 through 6, of our *Sunset Evaluation Report, Regulation of Mortgage Brokers and Solicitors, Chapter 454, Hawaii Revised Statutes*.

The report contains our recommendations relating to the regulation of mortgage brokers and solicitors. If you have any comments on our recommendations, we would appreciate receiving them by November 21, 1988. Any comments we receive will be included as part of the final report which will be submitted to the Legislature.

Since the report is not in final form and changes may possibly be made to it, we request that you limit access to the report to those officials whom you wish to call upon for assistance in your response. Please do not reproduce the report. Should you require additional copies, please contact our office. Public release of the report will be made solely by our office and only after the report is published in its final form.

We appreciate the assistance and cooperation extended to us.

Sincerely,

Clinton T. Tanimura
Legislative Auditor

Enclosures

ATTACHMENT 2



JOHN WAIHEE
GOVERNOR

ROBERT A. ALM
DIRECTOR
COMMISSIONER OF SECURITIES

SUSAN DOYLE
DEPUTY DIRECTOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
1010 RICHARDS STREET
P. O. BOX 541
HONOLULU, HAWAII 96809

December 2, 1988

RECEIVED

DEC 2 3 43 PM '88

OFF. OF THE AUDITOR
STATE OF HAWAII

Mr. Clinton Tanimura
Legislative Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

We appreciate the opportunity to provide a consolidated response to your sunset evaluation reports of Chapter 454D, HRS, Mortgage and Collection Servicing Agents and Chapter 454, HRS, Mortgage Brokers and Solicitors. In that you have recommended changes to Chapter 454D which impact Chapter 454, our response will provide a total overview of your comments.

In addressing first the recommendations to Chapter 454D, on Mortgage and Collections Servicing Agents, we agree that this chapter should be reenacted to provide for the continued regulation of servicing agents.

Further, we can support the recommendation to amend Chapter 454D to require servicing agents to provide customers with annual and closing statements which show the amounts the servicing agent received, disbursed, together with any remaining balances.

Moreover, we will not dispute the rationale to exempt mortgage bankers from Chapter 454D as you feel they should be regulated only as mortgage brokers under Chapter 454. However, there is one very important point that failed to be mentioned with the merger of mortgage bankers with mortgage brokers and that is that there is a sizeable disparity in the bonding requirement for the two areas. Currently, mortgage bankers under Chapter 454D require a \$50,000 bond. Mortgage brokers on the other hand require only a \$15,000 bond under Chapter 454. With your proposal no recommendation was provided on what should be done regarding the bonding

Mr. Clinton Tanimura
December 2, 1988
Page 2

requirements with such a merger. We strongly believe that the current \$50,000 bonding requirement should be retained, and as such the bond requirements for mortgage brokers needs to be increased from \$15,000 to \$50,000. Whether you thought of this impact is unknown, but it is a substantive issue that needs to be reviewed and commented upon as you respond to the Legislature.

Amending the title of Chapter 454D to exclude "Mortgage" Agents is acceptable; provided the regulation of mortgage agents under Chapter 454 carries with it the same bonding requirement of \$50,000.

We now would like to address your recommendations with regard to Chapter 454, Mortgage Brokers and Solicitors.

We agree that Chapter 454 should be reenacted to provide for continued regulation; statutory clarification is appropriate to amend the definition for "mortgage brokers" to cover the broker's activities in relationship to borrowers; deletion of the restriction to no more than 25 transactions a year by a broker is acceptable; and that provisions be enacted to require mortgage brokers to prepare an "Honor Agreement" identifying the respective responsibilities of the borrowers and the mortgage brokers including disclosing all fees, closing costs, refund conditions, and referral fees received.

With regard to the recommendation to place the mortgage brokers and solicitors program with the Commissioner of Financial Institutions (hereafter referred to as "CFI"), we offer the following:

- (1) Given the concerns raised with the current administration of the program, simply placing the program with the CFI will not in itself make the situation better and, in fact, may make the situation worse. Key to shifting the responsibility to the CFI is providing the necessary resources needed to implement a new program beyond their current jurisdiction and resources available. As you were able to observe, several staff members within the Professional and Vocational Licensing Division handled the administration of the program.

Mr. Clinton Tanimura
December 2, 1988
Page 3

Absent any comparable staff being awarded to the CFI, the program cannot be implemented. We note that there is no mention of additional resources to the CFI which we believe to be a major oversight to the goals you wish to have accomplished.

- (2) Assuming the CFI accepts jurisdiction of the program resources become even more crucial in working with the law and developing rules that afford the protection deemed necessary by the CFI. Thought has been given by the CFI to strengthen the law including adding provisions on prohibited practices, cease and desist authority and including the provisions recommended for rules (page 24, No. 2.) in the statute. Considerable time, effort and adequate training of staff will be necessary to make the program fully enforceable.
- (3) While you stress that the CFI has the ability to examine financial institutions pursuant to Chapter 401, HRS, the scope is limited in fact only to financial institutions. If it is intended for the CFI to examine mortgage brokers, then clear statutory authority is needed. Expanding examination functions to include mortgage brokers will necessitate resources beyond what is described above.

In conclusion we find that many important aspects to fully effectuate the changes recommended in your reports were not addressed and we appreciate the opportunity to add them in in order that the Legislature can adequately assess the situation.

Very truly yours,



Robert A. Alm
Director

APPENDIX B

DIGEST

A BILL FOR AN ACT RELATING TO MORTGAGE BROKERS AND SOLICITORS

Deletes the chapter regulating mortgage brokers and solicitors from the sunset law. Places the regulation of mortgage brokers under the purview of the commissioner of financial institutions. Requires mortgage brokers and solicitors to prepare and execute an honor agreement which clearly delineates the responsibilities in a transaction of both the borrower and the mortgage broker or solicitor. Requires the mortgage broker or solicitor to disclose in such agreement any referral fees received from lenders, the terms and conditions of the loan, the types of fees to be charged the borrower and whether such fees are refundable, the closing costs, and the monthly payment plans. Clarifies that the law does not apply to transactions between a mortgage broker or a mortgage solicitor and a lending institution or an investor. Repeals the provision restricting mortgage brokers and solicitors to no more than 25 transactions a year.

(To be made one and seven copies)

THE SENATE
FIFTEENTH..... LEGISLATURE, 19 89
STATE OF HAWAII

S.B. NO.

A BILL FOR AN ACT

RELATING TO MORTGAGE BROKERS AND SOLICITORS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Section 26H-4, Hawaii Revised Statutes, is amended to read as follows:

"§26H-4 Repeal dates. (a) The following chapters are hereby repealed effective December 31, 1989:

- (1) Chapter 444 (Contractors License Board)
- (2) Chapter 448E (Board of Electricians and Plumbers)
- (3) Chapter 464 (Board of Registration of Professional Engineers, Architects, Surveyors and Landscape Architects)
- (4) Chapter 466 (Board of Public Accountancy)
- (5) Chapter 467 (Real Estate Commission)
- (6) Chapter 439 (Board of Cosmetology)
- [(7) Chapter 454 (Mortgage Brokers and Solicitors)
- (8)] (7) Chapter 454D (Mortgage and Collection Servicing Agents)
- (b) The following chapter and sections are hereby repealed

1 effective December 31, 1990:

- 2 (1) Chapter 466J (Board of Radiologic Technology)
- 3 (2) Sections 321-13 to 321-15 (midwives, laboratory
- 4 directors, laboratory technologists, laboratory
- 5 supervisors, laboratory technicians, tattoo artists,
- 6 electrologists, and sanitarians)

7 (c) The following chapters are hereby repealed effective

8 December 31, 1991:

- 9 (1) Chapter 447 (Dental Hygienists)
- 10 (2) Chapter 453 (Board of Medical Examiners)
- 11 (3) Chapter 457 (Board of Nursing)
- 12 (4) Chapter 458 (Board of Dispensing Opticians)
- 13 (5) Chapter 460J (Pest Control Board)
- 14 (6) Chapter 462A (Pilotage)
- 15 (7) Chapter 438 (Board of Barbers)
- 16 (8) Chapter 468K (Travel Agencies)

17 (d) The following chapters are hereby repealed effective

18 December 31, 1992:

- 19 (1) Chapter 448H (Elevator Mechanics Licensing Board)
- 20 (2) Chapter 451A (Board of Hearing Aid Dealers and Fitters)
- 21 (3) Chapter 457B (Board of Examiners of Nursing Home
- 22 Administrators)
- 23
- 24

1 (4) Chapter 460 (Board of Osteopathic Examiners)

2 (5) Chapter 461 (Board of Pharmacy)

3 (6) Chapter 461J (Board of Physical Therapy)

4 (7) Chapter 463E (Podiatry)

5 (e) The following chapters are hereby repealed effective
6 December 31, 1993:

7 (1) Chapter 437 (Motor Vehicle Industry Licensing Board)

8 (2) Chapter 437B (Motor Vehicle Repair Industry Board)

9 (3) Chapter 440 (Boxing Commission)

10 (4) Chapter 446 (Debt Adjusters)

11 (5) Chapter 436E (Board of Acupuncture)

12 (f) The following sections are hereby repealed effective
13 December 31, 1993:

14 (1) Sections 445-21 to 38 (Auctions)

15 (2) Sections 445-131 to 136 (Pawnbrokers)

16 (3) Sections 445-171 to 172 (Secondhand Dealers)

17 (4) Sections 445-231 to 235 (Scrap Dealers)

18 (g) The following chapters are hereby repealed effective
19 December 31, 1994:

20 (1) Chapter 441 (Cemetery and Funeral Trusts)

21 (2) Chapter 443B (Collection Agencies)

22 (3) Chapter 452 (Board of Massage)

23

24

25

1 (4) Chapter 455 (Board of Examiners in Naturopathy)

2 (5) Chapter 459 (Board of Examiners in Optometry)

3 (6) Chapter 442 (Board of Chiropractic Examiners)

4 (7) Chapter 373 (Commercial Employment Agencies)

5 (8) Chapter 448 (Board of Dental Examiners)

6 (9) Chapter 465 (Board of Psychology)

7 (10) Chapter 468E (Speech Pathology and Audiology)

8 (h) The following chapters are hereby repealed effective
9 December 31, 1997:

10 (1) Chapter 463 (Board of Private Detectives and Guards)

11 (2) Chapter 471 (Board of Veterinary Examiners)."

12 SECTION 2. Chapter 454, Hawaii Revised Statutes, is amended
13 as follows:

14 1. By adding a new section to be appropriately designated
15 and to read:

16 "§454- Honor agreement. For any transaction between a
17 mortgage broker or a mortgage solicitor and a borrower, the
18 mortgage broker or mortgage solicitor shall cause to be prepared
19 and executed, an honor agreement which clearly delineates the
20 responsibilities in the transaction of both the borrower and the
21 mortgage broker or solicitor. The mortgage broker or mortgage
22 solicitor shall disclose in the honor agreement any referral fees

S.B. NO.

1 received from lenders, the terms and conditions of the loan, the
2 types of fees to be charged the borrower and whether such fees
3 are refundable, the closing costs, and the monthly payment
4 plans."

5 2. By amending section 454-1 to read:

6 "**§454-1 Definitions.** In this chapter unless the context or
7 subject matter otherwise requires:

8 [(1)] "Person" means an individual, partnership,
9 corporation, association, or other organization.

10 [(2)] "Mortgage loan" means a loan secured by a mortgage on
11 real property.

12 [(3)] "Mortgage broker" means a person not exempt under
13 section 454-2 who for compensation or gain, or in the expectation
14 of compensation or gain, either directly or indirectly makes,
15 negotiates, acquires, [or sells] or offers to make, negotiate, or
16 acquire[, or sell] a mortgage loan[, but excluding transactions
17 involving the sale or purchase of notes or bonds secured by
18 mortgages which are subject to registration under chapter 485.]
19 on behalf of a borrower seeking a mortgage loan.

20 [(4)] "Mortgage solicitor" means an individual not licensed
21 as a mortgage broker who performs any of the functions set forth
22 in paragraph (3) of this section and who is employed by a
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S. B. NO.

1 mortgage broker or whose business transactions are under the
2 direction, control, or management of a mortgage broker.

3 [(5)] "Mortgage commissioner" or "commissioner" means the
4 [director of commerce and consumer affairs.] commissioner of
5 financial institutions.

6 [(6)] "Licensee" means a person, whether mortgage broker or
7 mortgage solicitor, licensed under this chapter.

8 [(7)] "License" means a license issued under this chapter.

9 [(8)] "Institutional investor" means and includes (a) banks,
10 savings and loan institutions, trust companies, insurance
11 companies, investment companies as defined in the Investment
12 Company Act of 1940, pension or profit sharing trusts, any of the
13 class of persons permitted to qualify as foreign lenders under
14 section 207-11, or other financial institutions or institutional
15 buyers, whether acting for themselves or as fiduciaries; (b) the
16 United States or any foreign government, any state or territory
17 thereof, or any agency or corporate or other instrumentality of
18 the United States, a foreign government, or of any state,
19 territory or political subdivision thereof.]"

20 3. By amending section 454-2 to read:

21 "**§454-2 Exemptions.** This chapter does not apply to the
22 following:
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S.B. NO.

- 1 (1) Banks, trust companies, building and loan associations,
2 pension trusts, credit unions, insurance companies,
3 industrial loan companies, or federally licensed small
4 business investment companies, authorized under any law
5 of this State or of the United States to do business in
6 the State;
- 7 (2) A person making or acquiring a mortgage loan with one's
8 own funds for one's own investment without intent to
9 resell the mortgage loan;
- 10 (3) A person licensed to practice law in the State, not
11 actively and principally engaged in the business of
12 negotiating loans secured by real property, when the
13 person renders services in the course of the person's
14 practice as an attorney; [and]
- 15 (4) A person licensed as a real estate broker or salesman
16 in the State, not actively engaged in the business of
17 negotiating loans secured by real property, when the
18 person renders services in the course of the person's
19 practice as a real estate broker or salesman[.]; and
- 20 (5) Any transaction between a mortgage broker or a mortgage
21 solicitor and a lending institution or an investor."

22 4. By repealing section 454-3.5.

