

RESOLUTION 06-03-2007

DIGEST

Predatory Lending: Yield Spread Premium in Calculation of Covered Loans

Amends Financial Code section 4970 to include the Yield Spread Premium paid to brokers in defining points and fees for calculating predatory loan schemes.

RESOLUTIONS COMMITTEE RECOMMENDATION

APPROVE IN PRINCIPLE

History:

No similar resolutions found.

Reasons:

This resolution amends Financial Code section 4970 to include the Yield Spread Premium paid to brokers in defining points and fees for calculating predatory loan schemes. This resolution should be approved in principle because it cures a defect in the Financial Code dealing with predatory lending.

Section 4970 defines the types of loans covered by the predatory lending laws of California. Whether a particular loan is predatory is determined by a relatively simple calculation of points and fees. At a certain limit, dependent on individual circumstances of each loan, the proposed lender is deemed to have engaged in predatory lending. For example, fees and costs in excess of a certain percentage of a residential mortgage loan to a low-income borrower might result in a loan being considered predatory.

The current text of section 4970 excludes from the calculation the Yield Spread Premium (“YSP”) paid to loan brokers in connection with residential mortgages. YSP’s typically take the form of promissory notes for the amount of premiums associated with processing mortgages, calculated on a sliding scale related to the cost of the loan. The YSP can equal tens of thousands of dollars on a single loan. These costs are passed directly onto consumers and, by consequence of the current law, are not taken into consideration for the purposes of determining whether a broker has engaged in predatory lending.

By failing to include the premiums paid to loan brokers, consumers are not being availed of the entire spirit and intent of the predatory lending laws. This resolution cures that defect by including narrow and specific language into section 4970 that includes YSP’s along with other enumerated parts of the calculation.

TEXT OF RESOLUTION

RESOLVED, that the Conference of Delegates of California Bar Associations recommends that legislation be sponsored to amend Financial Code section 4970 to read as follows:

1 §4970.

2 For purposes of this division:

3 (a) "Annual percentage rate" means the annual percentage rate for the loan
4 calculated according to the provisions of the federal Truth in Lending Act and the
5 regulations adopted thereunder by the Federal Reserve Board.

6 (b) "Covered loan" means a consumer loan in which the original principal balance of
7 the loan does not exceed the most current conforming loan limit for a single-family first
8 mortgage loan established by the Federal National Mortgage Association in the case of a
9 mortgage or a promissory note secured by deed of trust, and where one of the following
10 conditions ~~are~~ is met:

11 (1) For a mortgage or promissory note secured by deed of trust, the annual
12 percentage rate at consummation of the transaction will exceed by more than eight
13 percentage points the yield on Treasury securities having comparable periods of maturity on
14 the 15th day of the month immediately preceding the month in which the application for the
15 extension of credit is received by the creditor.

16 (2) The total points and fees payable by the consumer during the term of the ~~at or~~
17 ~~before closing for a mortgage or~~ promissory note secured by deed of trust will exceed 6
18 percent of the total loan amount.

19 (c) "Points and fees" shall include the following:

20 (1) All items required to be disclosed as finance charges under Sections 226.4(a) and
21 226.4(b) of Title 12 of the Code of Federal Regulations, including the Official Staff
22 Commentary, as amended from time to time, except interest.

23 (2) All compensation and fees paid to mortgage brokers in connection with the loan
24 transaction.

25 (3) All items listed in Section 226.4(c)(7) of Title 12 of the Code of Federal
26 Regulations, only if the person originating the covered loan receives direct compensation in
27 connection with the charge.

28 (d) "Consumer loan" means a consumer credit transaction that is secured by real
29 property located in this state used, or intended to be used or occupied, as the principal
30 dwelling of the consumer that is improved by a one-to-four residential unit. "Consumer
31 loan" does not include a reverse mortgage, an open line of credit as defined in Part 226 of
32 Title 12 of the Code of Federal Regulations (Regulation Z), or a consumer credit transaction
33 that is secured by rental property or second homes. "Consumer loan" does not include a
34 bridge loan. For purposes of this division, a bridge loan is any temporary loan, having a
35 maturity of one year or less, for the purpose of acquisition or construction of a dwelling
36 intended to become the consumer's principal dwelling.

37 (e) "Original principal balance" means the total initial amount the consumer is
38 obligated to repay on the loan.

39 (f) "Licensing agency" shall mean the Department of Real Estate for licensed real
40 estate brokers, the Department of Corporations for licensed residential mortgage lenders and
41 licensed finance lenders and brokers, and the Department of Financial Institutions for
42 commercial and industrial banks and savings associations and credit unions organized in this
43 state.

44 (g) "Licensed person" means a real estate broker licensed under the Real Estate Law

45 (Part 1 (commencing with Section 10000) of Division 4 of the Business and Professions
46 Code), a finance lender or broker licensed under the California Finance Lenders Law
47 (Division 9 (commencing with Section 22000)), a residential mortgage lender licensed under
48 the California Residential Mortgage Lending Act (Division 20 (commencing with Section
49 50000)), a commercial or industrial bank organized under the Banking Law (Division 1
50 (commencing with Section 99)), a savings association organized under the Savings
51 Association Law (Division 2 (commencing with Section 5000)), and a credit union
52 organized under the California Credit Union Law (Division 5 (commencing with Section
53 14000)). Nothing in this division shall be construed to prevent any enforcement by a
54 governmental entity against any person who originates a loan and who is exempt or
55 excluded from licensure by all of the licensing agencies, based on a violation of any
56 provision of this division. Nothing in this division shall be construed to prevent the
57 Department of Real Estate from enforcing this division against a licensed salesperson
58 employed by a licensed real estate broker as if that salesperson were a licensed person under
59 this division. A licensed person includes any person engaged in the practice of consumer
60 lending, as defined in this division, for which a license is required under any other provision
61 of law, but whose license is invalid, suspended or revoked, or where no license has been
62 obtained.

63 (h) "Originate" means to arrange, negotiate, or make a consumer loan.
64 (i) "Servicer" has the same meaning provided in Section 6 (i)(2) of the Real Estate
65 Settlement Procedures Act of 1974.

(Proposed new language underlined, language to be deleted stricken)

PROPONENT: Sacramento County Bar Association

STATEMENT OF REASONS:

Existing Law: Provides that for a covered loan under the California Predatory Lending Law (Financial Code Section 4970 *et seq*) the calculation of fees paid is based on what is paid at or before closing of the loan. It does not take into account the Yield Spread Premium paid to Brokers as bonuses and charged to the consumer during the lifetime of the loan.

This Resolution: Would require that the Yield Spread Premium paid to loan brokers in connection with a residential mortgage loan be included in the definition of points and fees payable by a borrower so as to include the loan as covered under the California predatory lending law. This resolution also adds promissory notes secured by a deed of trust to the definition of a "covered" loan."

The Problem: Section 4970 does not require that broker fees in the nature of Yield Spread Premium be calculated in determining whether a loan is covered under the act. A Yield Spread Premium is a bonus paid to a broker when it originates a loan at an interest rate higher than the minimum interest rate approved by the lender for a particular loan. The consumer pays a higher interest rate over the life of the loan to compensate for the payment to the broker. As a result,

many predatory loans are technically outside the scope of the predatory lending law even though they are abusive. "Predatory lending" is a term generally used to characterize a range of abusive and aggressive lending practices, including deception or fraud, charging excessive fees and interest rates, making loans without regard to a borrower's ability to repay, or refinancing loans repeatedly over a short period of time to incur additional fees without any economic gain to the borrower. Predatory lending is most likely to occur in the rapidly growing "subprime" mortgage market, which is a market generally providing access to borrowers with impaired credit, limited income, or high debt relative to their income. Mortgages in this market tend to be in smaller amounts, and with faster prepayments and significantly higher interest rates and fees, than "prime" mortgages. (*American Financial Services Assn v. City of Oakland* (2005) 34 Cal.4th 1239). This resolution recognizes the public policy which encourages full disclosure of all aspects of the loan transaction to the consumer.

IMPACT STATEMENT

This resolution does not affect any other law, statute or rule.

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