FINAL REPORT
OF THE
INTERIM STUDY COMMITTEE ON
MORTGAGE LENDING PRACTICES AND
HOME LOAN FORECLOSURES

Indiana Legislative Services Agency
200 W. Washington Street, Suite 301
Indianapolis, Indiana 46204

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INTERIM STUDY COMMITTEE ON MORTGAGE LENDING PRACTICES AND HOME LOAN FORECLOSURES

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A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Committee can be accessed from the General Assembly Homepage at http://www.in.gov/legislative/.

I. STATUTORY DIRECTIVE

P.L. 230-2007 (HEA 1717-2007), SEC. 30, established the Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures and directed the Committee to study the following:

(1) The appropriateness of requiring state licensure for all mortgage lenders, loan brokers, originators, settlement service providers, and real estate appraisers.

(2) The appropriate state agency or regulatory body to oversee the regulation of mortgage lenders, loan brokers, originators, settlement service providers, and real estate appraisers.

(3) Other states' approaches to regulating mortgage lenders, loan brokers, originators, settlement service providers, and real estate appraisers. In examining the regulatory approaches of other states under this subdivision, the committee shall attempt to identify those approaches that:

(A) incorporate an efficient or streamlined regulatory framework; or

(B) otherwise represent best practices for state regulation of mortgage lenders, loan brokers, originators, settlement service providers, and real estate appraisers.

(4) The causes of home loan foreclosures in Indiana, including a study of the causes of home loan foreclosures with respect to new home construction in Indiana.

(5) Whether legislative or regulatory solutions exist to:

(A) prevent or reduce the number of home loan foreclosures in Indiana; and

(B) prevent or reduce the occurrence of fraudulent practices in the home loan industry.

(6) Issues concerning the referral of borrowers or potential borrowers to appraisal companies by mortgage lenders, loan brokers, originators, or settlement service providers that have an:

(A) ownership or investment interest in or compensation arrangement with an appraisal company; or

(B) immediate family member that has an ownership or investment interest in or compensation arrangement with an appraisal company.

(7) Issues concerning the referral of settlement service providers by mortgage lenders, loan brokers, or originators that have:

(A) a business relationship or an ownership interest in a settlement service provider; or

(B) an immediate family member that has a business relationship or an ownership interest in a settlement service provider.

(8) The appropriateness of requiring a person licensed under IC 23-2-5 to notify the commissioner if the employment of a person registered under IC 23-2-5 is terminated.

(9) Other topics that the committee considers relevant in:

(A) examining mortgage lending practices and home loan foreclosures in Indiana; and
(B) devising solutions to the problems identified.

II. INTRODUCTION AND REASONS FOR STUDY

The topics assigned to the Committee by P.L. 230-2007 (HEA 1717-2007), SEC. 30, were derived from subjects contained in various bills considered by the General Assembly during the 2007 session. The topics were generated from legislators' recognition that Indiana continues to experience high rates of mortgage foreclosures when compared to other states, and from their concern that certain fraudulent practices have contributed to these high foreclosure rates.

III. SUMMARY OF WORK PROGRAM

The Committee met four times after the conclusion of the 2007 session of the General Assembly. All four meetings were held at the State House in Indianapolis.

(1) August 16, 2007:

The Committee received an overview of the following:

(1) The number and location of properties in foreclosure in Indiana.
(2) The possible causes for high rates of mortgage foreclosures in Indiana and other states.
(3) Mortgage lending guidelines issued by federal and state regulators.
(4) The role of property taxes in contributing to foreclosures among newly constructed homes and the appropriateness of requiring property tax estimates to be provided to purchasers of newly constructed homes.

(2) September 13, 2007:

The Committee heard testimony on the following:

(1) Fraudulent practices in the home loan industry, including testimony on:
  (A) the difficulty of determining the scope and extent of mortgage fraud;
  (B) efforts to enforce existing lending laws;
  (C) the prosecution of complicated mortgage fraud schemes; and
  (D) potential legislative solutions.
(2) The regulation of lenders, brokers, originators, settlement service providers, and appraisers. The discussion included a consideration of arguments for and against centralizing the regulatory efforts for which a number of state agencies are currently responsible.

(3) October 11, 2007:

The Committee received additional testimony on mortgage fraud schemes from a state police investigator and a consumer impacted by fraud. Various witnesses then suggested ways to address the problems of home loan foreclosures and mortgage fraud through regulatory and educational efforts. The meeting ended with a discussion by Committee members of concepts they would like to include in the Committee's final report.

(4) October 30, 2007:

The Committee considered two drafts of proposed bills:

(1) PD 3402, which would make various changes to the statute governing the regulation of loan brokers (IC 23-2-5); and

(2) PD 5678, which includes various provisions that require or encourage lenders to take certain actions, including homeownership education efforts, that are designed to prevent additional mortgage foreclosures.

The Committee also reviewed and adopted the draft of this final report.

IV. SUMMARY OF TESTIMONY

The Committee heard testimony from the individuals on the witness list included with this report. Further information on the testimony provided is contained in the meeting minutes, which can be accessed from the General Assembly Homepage at http://www.in.gov/legislative/. The following is a summary of the testimony concerning each of the issues considered by the Committee:

(1) The number and location of properties in foreclosure in Indiana:

(A) Sherry Seiwert, Executive Director of the Indiana Housing and Community Development Authority (IHCDA), provided an overview of home loan foreclosures in Indiana. Ms. Seiwert cited data from the Mortgage Bankers Association indicating that 2.98% of all loans in Indiana are in foreclosure, compared to a national foreclosure rate of 1.28%. This statistic places Indiana second in the nation (behind Ohio) among the states with the highest foreclosure rates. While ranking near the top in terms of high foreclosure rates, Indiana ranks among the bottom five states with respect to home value appreciation rates. Ms. Seiwert suggested that the low appreciation rate in Indiana could be one of several factors contributing to the state's higher foreclosure rate. She additionally reported that the IHCDA has been working to implement a program to provide free mortgage foreclosure counseling to homeowners, as authorized by the General Assembly with the enactment of HEA 1753-2007.

(B) Seth Payton, Senior Policy Analyst at the Center for Urban Policy and the Environment, presented the results of a study he conducted on statewide patterns of foreclosures. The study examined whether foreclosures were concentrated in certain areas in the state and, if so, in what kind of environments they occurred. Mr. Payton explained that he obtained data on Indiana foreclosures from 2002 through 2005. He then mapped out the data in block groups, or concentrations, across the state. In describing this mapping process to the Committee, Mr. Payton displayed statewide maps for each year from 2002 through 2005, with each map using different colors to illustrate different concentrations of foreclosed properties. All of the maps revealed a higher concentration of foreclosures in urban areas. The maps also showed a progressive spreading of higher concentration areas throughout the state with each passing year.

According to Mr. Payton, the data showed that areas with higher concentrations of foreclosures had higher percentages of low income residents. He further reported that areas with high concentrations of foreclosures also tend to occur in neighborhoods in which: (1) the housing supply outstrips demand; (2) homes prices range from $80,000 to $120,000; (3) home prices are declining or appreciating at a slower rate; or (4) there is a high rate of property abandonment.

(2) The possible causes for high rates of mortgage foreclosures in Indiana and other states:

(A) In addition to presenting data on statewide patterns of foreclosures, Seth Payton also discussed factors that may contribute to high concentrations of foreclosures. He noted that in Indiana and elsewhere, the number of foreclosures tends to be highest under the following conditions: (1) In states whose foreclosure laws involve the judicial process, because properties tend to move more slowly through the process. (2) When certain types of loan products are involved, such as adjustable rate mortgages (ARMs) and loans with high loan-to-value (LTV) ratios. (3) When mortgage fraud is involved. (4) When the mortgage involves a low income borrower. (5) In areas in which home values are declining or appreciating at a low rate.

(B) Thomas Dinwiddie, an attorney for the Indiana Mortgage Bankers Association, discussed the history of mortgage lending in the United States. In describing the evolution of the subprime market, Mr. Dinwiddie explained that the proliferation of subprime loans in recent years has been partly in response to the nationwide focus on encouraging homeownership. According to Mr. Dinwiddie, by making loans available to less creditworthy borrowers, the subprime industry has indeed led to record levels of homeownership. However, with more high-risk borrowers owning homes, the number of loan defaults has correspondingly increased.

Mr. Dinwiddie pointed out that in Indiana, the high foreclosure rate is not as highly correlated with the subprime market as it is in other states. Rather, Indiana's 2.98% foreclosure rate is largely connected with a loss of manufacturing jobs, a low home-price appreciation rate, and a loan mix that consists of a high percentage of low-down payment loans. He noted that among the low-down payment loans in Indiana, a high percentage of them are Federal Housing Administration (FHA)-insured loans, which are associated with higher foreclosure rates throughout the country.

(C) Sally Johnson, Government Affairs Director for the Indiana Association of Realtors (IAR), discussed a study conducted by the IAR and the National Association of Realtors. First published in 2004, the study examined the causes of the disparity between Indiana's foreclosure rate and the national foreclosure rate. In August 2007, the data from this study was updated and revealed that the gap between Indiana's foreclosure rate (3.0%) and the national foreclosure rate (1.1%) had widened over the past year. According to Ms. Johnson, the new study suggests that five key factors have contributed to this widening gap: (1) job losses in Indiana; (2) the number of first-time home buyers in Indiana; (3) loans with high LTV ratios; (4) the state's slow rate of home price appreciation; and (5) certain lending practices.

(D) Amber Van Til, Vice President of Government Relations for the Indiana Bankers Association, presented statistics concerning foreclosures among the various types of loans issued by federally regulated commercial banks and thrifts in Indiana. She explained that as depository institutions, these institutions issue mostly prime loans. She then cited the top reasons for foreclosure among borrowers of loans issued by depository institutions: (1) job loss or loss of income; (2) divorce; (3) death; (4) medical crises, including lack of health insurance or loss of income due to time off for medical reasons; and (5) poor money management, including credit card debt and bankruptcy.

(3) Mortgage lending guidelines issued by federal and state regulators:

In addition to discussing the reasons for foreclosure among borrowers of loans issued by depository institutions, Ms. Van Til described recent guidance to lenders issued by the federal financial regulatory agencies: the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Association (NCUA), and the Federal Reserve Board.

On October 4, 2006, the agencies issued the "Interagency Guidance on Nontraditional Mortgage Product Risks." This guidance sets forth standards that should be followed in underwriting "nontraditional loans," such as interest-only loans and "payment option" ARMs. On November 14, 2006, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) issued parallel guidance for state-regulated lenders. Both sets of guidelines provide that originators should: (1) analyze a borrower's repayment ability based on the fully indexed interest rate for the mortgage; (2) alert consumers to the risks of particular products in a timely manner; (3) provide clear and balanced information about the risks of products in all communications; and (4) inform consumers of potential increases in payments, including payment obligations once interest rate and negative amortization caps have been reached.

On June 29, 2007, the federal agencies issued their "Statement on Subprime Mortgage Lending," which was followed by a similar statement issued by CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA) on July 17, 2007. On August 9, 2007, the Indiana Secretary of State and the DFI adopted the guidance issued by CSBS, AARMR, and NACCA. Both sets of subprime guidelines require lenders to provide consumers with information concerning payment shock, responsibility for taxes and insurance, prepayment penalties, balloon payments, and increased costs associated with stated-income or reduced-documentation loans.

(4) The role of property taxes in contributing to foreclosures among newly constructed homes and the appropriateness of requiring property tax estimates to be provided to purchasers of newly constructed homes:

(A) Representing the home construction industry, Mike Hannigan, President of The Hannigan Company, LLC, noted the cyclical nature of the housing market. He argued that the introduction of risky, nontraditional mortgage products in recent years represents an erosion of common-sense business principles. He urged legislators to be cautious about addressing the current situation through regulatory action, urging them instead to let the housing market correct itself.

(B) Rick Wajda, CEO of the Indiana Builders Association, addressed concerns that the Indiana housing market is saturated with newly built homes. Mr. Wajda acknowledged that there are high levels of inventory at certain price points in certain markets in Indiana. However, Mr. Wajda explained that these high-inventory areas are the result of homes that have been in the construction pipeline for the past two years coming onto the market at the same time. He further pointed out that the market has recently been correcting itself, with the number of new home permits in Indiana decreasing 28% from 2006 to 2007.

Mr. Wajda stated that his association's members remain opposed to any legislation that would require builders to provide property tax estimates to home buyers. Citing the difficulty of predicting the value at which a home will ultimately be assessed, he stressed that builders are not in a position to provide accurate estimates to buyers.

(C) Chris Beaumont, Vice President of Government Affairs for the Indiana Credit Union League (ICUL), acknowledged that the sudden increase in property taxes on new homes after they are fully constructed, combined with upwardly adjusting ARMs, can create financial difficulties for new home purchasers. He further acknowledged that a disclosure explaining the increase in property taxes on a fully improved lot can be valuable in protecting potential buyers from payment shock. However, he noted the dilemma that legislators face in determining who should provide the disclosure, when it should be given, and what it should be required to say.

Mr. Beaumont acknowledged that legislation proposed in 2007 to require builders (and then lenders, after the bill was amended) to provide property tax estimates had contained a provision absolving the builders and lenders from liability for the estimates provided. However, he stressed that nothing could be done legislatively to shield builders or lenders from the "reputation risk" that they would necessarily assume in having to provide estimates of future taxes. Furthermore, he suggested that such legislation, to the extent it were to apply to federally regulated institutions, could ultimately be preempted by federal regulators. In that case, state chartered institutions would be at a competitive disadvantage, in that they would have to assume a risk-inherent duty from which federally chartered institutions would be exempt.

In light of these concerns over legislatively mandated property tax estimates, Mr. Beaumont reported that the ICUL had voluntarily collaborated with builders, banks, and other lenders to prepare a proposed statement that could be distributed to potential buyers of new homes.

(D) Barry Wood, Director of Assessment for the Department of Local Government Finance (DLGF), explained that in assessing property, assessors have to base the assessed value on the purchase price. He noted that a property's assessed value depends largely on *when* it is assessed.

Mr. Wood urged legislators to encourage their constituents to apply for the homestead and mortgage exemptions. He also reminded the Committee that in 2008, the 2% "circuit breaker" enacted by the General Assembly would go into effect, providing additional relief for homeowners.

In response to a question from Senator Lawson, Mr. Wood indicated that it would not be very complicated or time-intensive to be for the DLGF to establish a calculator on its website that would enable builders or lenders to generate the type of estimates contemplated by the 2007 legislation.

(5) Fraudulent practices in the home loan industry:

(A) David Miller, Legislative Consultant for the Office of the Attorney General, spoke to the Committee about the difficulty of determining the scope and extent of mortgage fraud in Indiana. He explained that mortgage fraud is one of several factors contributing to Indiana's high foreclosure rate. Estimates of the percentage of foreclosures that involve mortgage fraud range from 5% to 13%. Mr. Miller explained that it is difficult to more precisely determine the role of fraud in foreclosures, because fraudulent schemes usually involve numerous players and transactions. Because of the complexity of many mortgage fraud schemes, the prosecution of these cases is challenging. However, Mr. Miller noted two cases pursued by state attorneys general that resulted in settlements for consumers. Both cases involved deceptive practices by mortgage lenders: one involved Household International, Inc., and resulted in a $484 million settlement for all fifty states in 2002; the other resulted in a $295 payment to the states by Ameriquest Mortgage in 2006.

(B) Gabrielle Owens, Director of the Homeowner Protection Unit (HPU) in the Office of the Attorney General, reported that the with the funding made available through the Homeowner Protection Unit Account, the HPU has hired special staff to investigate real estate appraisers and other real estate professionals suspected of fraudulent activity. She indicated that the hiring of these skilled investigators was necessitated by the multiple properties and multiple players involved in the typical mortgage fraud scheme. According to Ms. Owens, among the various participants in fraudulent schemes, real estate appraisers are often key players. Ms. Owens then described a typical mortgage fraud scheme, noting the role that inflated appraisals play in allowing the participants to obtain mortgage loans that far exceed the true value of the properties involved.

(C) Matt Light, Deputy Attorney General for the Consumer Protection Division, outlined a proposal for a comprehensive mortgage fraud statute. He explained that the statute would have three main sections: (1) a section defining several loan-related terms; (2) a section prohibiting specific fraudulent actions in mortgage transactions; and (3) a section setting forth enforcement mechanisms and penalties. According to Mr. Light, the "definitions" section would include "mortgage lending process" as a defined term, as well as a number of other terms related to mortgage lending. The "prohibitions" section would include a "laundry list" of prohibited acts, such as appraisal fraud, loan flipping, and promoting a fraudulent scheme. Finally, the "enforcement" section would have three components: (1) a cause of action for the Attorney General against violators, including the right to impose civil penalties; (2) a private cause of action for aggrieved parties; and (3) criminal penalties.

(D) Donna Eide, former Assistant United States Attorney for the Southern District of Indiana, and Co-Chair of the Indiana Mortgage Fraud and Foreclosure Prevention Task Force (Task Force), described the complexity of prosecuting cases involving mortgage fraud. Having prosecuted over 50 people involved in mortgage fraud schemes, Ms. Eide reported that 10 to 20 people are typically charged in connection with a scheme, including brokers, appraisers, and title agents. She noted that a mortgage fraud case can take over four years to prosecute, given the need to trace a series of transactions, subpoena numerous documents, and then prove the fraud beyond a reasonable doubt to a jury. Once a case finally does reach a jury, the jury is often overwhelmed by the amount and complexity of the evidence. The entire process is further hampered by the lack of resources available at both the federal and state levels to investigate and prosecute these cases.

Ms. Eide argued that the scarce resources available should be directed to preventing fraud, rather than prosecuting fraud after it occurs. She suggested that legislators focus on licensing requirements and background checks for appraisers, brokers, title agents, and other real estate professionals to ensure that criminals are not licensed in the first place. Regulatory agencies should also have the authority to summarily suspend licenses when fraudulent activity is suspected.

(E) Gary Avery, Vice President of First Republic Mortgage Corporation and Co-Chair of the Task Force, offered a number of suggestions for legislation to combat mortgage fraud. Mr. Avery shared the following proposals generated by the Task Force: (1) Require all deeds transferring title to residential real estate to include the sales price, the full name and signature of the buyer, and the names and license numbers of all professionals involved in the transaction. (2) Require out-of-state lenders to register with the state before offering loan products to Indiana consumers. (3) Require all licensing fees to be set aside for enforcement efforts and consumer education initiatives. (4) Establish a statewide database containing essential information on all residential real estate transactions in Indiana. (5) Establish a statewide real estate fraud hotline to allow the reporting of suspected fraud. (6) Require all real estate professionals licensed or regulated by state agencies to undergo a national criminal history background check.

Mr. Avery also discussed a more controversial proposal to merge into a single Department of Real Estate all the agencies that currently regulate the various professionals. He explained that he and Donna Eide had developed this concept as a way to streamline the regulatory process and to avoid duplication of efforts by different state agencies.

(F) Sergeant Chuck Cohen of the Criminal Intelligence Section of the Indiana State Police (ISP) stressed the complexity of investigating and prosecuting suspected mortgage fraud. He reported that the investigation phase alone can take up to two years.

Given the large number of records involved in the typical mortgage fraud case, Sergeant Cohen argued that there is a need for a statewide database for tracking mortgage documents and storing statistics on brokers and lenders. He pointed out that the existing loan broker statute (IC 23-2-5) requires brokers to maintain records for only two years. As a result, many documents are disposed of or destroyed before investigators can request them. In addition to tracking these records, a statewide database could provide useful statistics to regulators and investigators, such as data on the average loan-to-value (LTV) ratios of the loans originated by particular brokers.

Sergeant Cohen suggested that it would be helpful if all of the statutes related to residential real estate transactions were consolidated into a single article in the Indiana Code. He argued that the existing statutory structure, in which various provisions concerning these transactions are spread throughout the Code, has created legal defenses for those accused of fraud. He argued that the accused can "pick and choose" which of these various provisions apply to them, based on which are most favorable to their particular circumstances.

(6) Regulation of professionals involved in residential real estate transactions:

(A) O. Wayne Davis, Securities Commissioner for the Office of the Indiana Secretary of State, discussed recent changes to the regulation of loan brokers and originators through the enactment of HEA 1717 (2007). He explained that the new law gives additional authority to the Securities Commissioner to take certain enforcement actions against brokers, originators, and principal managers. He indicated that the Securities Division would propose additional legislation for the 2008 session to enable national criminal history checks by the FBI for all applicants for licensure or registration.

Mr. Davis acknowledged that there is some duplication of effort among the various state agencies involved in regulating real estate transactions. However, he maintained that the formation of a centralized Department of Real Estate would lead to a larger bureaucracy that would not have the focus or "nimbleness" of the individual agencies that currently regulate these transactions. He predicted that a centralized agency would be organized into departments, with no guarantee that the departments would collaborate any more by virtue of falling within the same agency. Mr. Davis argued that the existing agencies already collaborate and exchange information on an "operational level," making a restructuring of government unnecessary.

Looking forward, Mr. Davis suggested that the existing loan broker law could be amended to require originators to consider the suitability of a loan product for a prospective borrower before procuring the loan on the borrower's behalf. Mr. Davis further predicted that reverse mortgages will replace subprime loans as the product of concern for regulators.

(B) Judith Ripley, Commissioner of the Department of Financial Institutions (DFI), explained that her agency is responsible for regulating state-chartered depository institutions. In addition, the DFI oversees nondepository second-mortgage lenders under the Uniform Consumer Credit Code. However, Ms. Ripley pointed out that the DFI does not have statutory authority to regulate nondepository lenders that issue first mortgages on property. Ms. Ripley noted that Indiana is one of the few states that does not regulate nondepository first-mortgage lenders and urged legislators to consider giving the DFI the authority to do so.

Ms. Ripley reported that both the DFI and the Securities Division have signed on to participate in the National Mortgage Licensing Database established by CSBS and AARMR. The national database is set to go online in January 2008 and will allow the DFI to check the qualifications, background, and licensing status of lenders. To date, 38 other states have agreed to participate.

Ms. Ripley also reported that CSBS has proposed a two-page disclosure statement that would provide prospective borrowers with essential, timely information in a summary format before a real estate closing. Ms. Ripley encouraged legislators to require that such a disclosure be given to Indiana consumers.

(C) Carol Mihalik, Chief Deputy of the Consumer Protection Unit (CPU) in the Indiana Department of Insurance, testified about the regulation of title insurance agents and title insurance companies. Ms. Mihalik explained that while title insurance agents and title insurance companies represent a small percentage of the state's regulated insurance entities, they are engaged in specialized transactions that require specialized oversight. In recognition of the need for experienced regulators to oversee these companies and individuals, the Title Insurance Division was established within the CPU in April 2007. Ms. Mihalik explained that the Division is staffed by two attorneys and two field examiners and is funded through the Title Insurance Enforcement Fund. Established by the legislature in 2006, the Fund consists of fees paid by purchasers of title insurance policies.

(D) Wade Lowhorn, Deputy Director for the Indiana Professional Licensing Agency (IPLA), discussed the regulation of real estate appraisers. He explained that the IPLA provides administrative support for 38 professional licensing boards and commissions, including the Indiana Real Estate Commission (Commission) and the Real Estate Appraiser Licensure and Certification Board (Board). Real estate appraisers are regulated by the Board, which in turn falls under the jurisdiction of the Commission. Eight full-time IPLA employees work directly with the Commission, the Board, and the Home Inspectors Licensing Board.

Indiana's real estate appraiser regulatory program is also subject to federal oversight under Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Mr. Lowhorn explained that FIRREA required states to create a licensing and certification program for real estate appraisers. FIRREA further authorized the Appraisal Subcommittee (ASC), a government agency consisting of representatives from the federal financial institutions regulatory agencies and the U.S. Department of Housing and Urban Development (HUD). Funded through a surcharge on state licensing fees, the ASC conducts periodic field reviews of each state's regulatory program and maintains a national online registry of all licensed and certified appraisers.

Mr. Lowhorn noted that the Board recently adopted rules to establish more stringent qualifications standards for licensing and certification, as mandated by the federal government. These rules will take effect on January 1, 2008, and will increase the educational requirements for licensure and certification.

Mr. Lowhorn explained that the number of disciplinary cases brought against appraisers has increased due to recent legislation that has given IPLA increased authority to investigate and take enforcement action against real estate appraisal fraud. For example, in 2005, the legislature increased the licensing surcharge that funds the Real Estate Investigative Fund from \$10 to \$20. The increased surcharge generates about \$500,000 per year for the Fund, the proceeds of which are shared by the Attorney General and the IPLA for investigative and enforcement activities. However, Mr. Lowhorn noted that the relevant statute specifies that if the amount in the Fund exceeds \$750,000, the amount above that threshold reverts to the State General Fund. Mr. Lowhorn urged legislators to amend the law to allow all money to remain in the Real Estate Investigative Fund to further enhance the enforcement capabilities of the two agencies.

(7) Regulatory and educational solutions to address mortgage fraud and foreclosures:

(A) Dr. John Weicher, Director of the Center for Housing and Financial Markets at the Hudson Institute reported on three measures that have been undertaken at the national level to address the problems in the subprime market: (1) loan forbearance; (2) consumer counseling; and (3) refinancing subprime loans into FHA-insured loans.

First, in April 2007, the federal financial regulatory agencies issued guidance to lenders that are financial institutions, encouraging them to offer forbearance or pursue workout arrangements with homeowners unable to make their mortgage payments, particularly those borrowers with subprime ARMs.

In addition to recommending forbearance, the guidance also urged lenders to offer home ownership counseling to borrowers. Dr. Weicher explained that HUD maintains a list of approved counseling agencies and provides funding for them. According to Dr. Weicher, data collected by FHA on FHA-insured loans have indicated that those borrowers who receive home ownership counseling are significantly less likely to default on their loans. These findings, in turn, led Congress to approve substantial funding increases for housing counseling.

Finally, in late August, President Bush announced the "FHA Secure" program to help subprime ARM borrowers unable to make their mortgage payments following an interest rate adjustment. Before this program, the FHA would not insure new loans for homeowners delinquent on their existing mortgages. Under FHA Secure, however, FHA will insure new loans for borrowers unable to make the payments on their existing mortgages after an interest rate reset occurring between June 2005 and December 2008, as long as the borrower has a history of on-time mortgage payments before the reset. Still, in order to receive a new FHA-insured loan, the borrower must otherwise meet FHA's standard underwriting criteria, including having 3% of the home's value in cash or equity and sufficient income to make the mortgage payments.

(B) John Ryan, Executive Vice President of CSBS, provided information on recent actions taken by the states to regulate the mortgage industry, including the development of the following: (1) a nationwide licensing system for mortgage professionals; (2) uniform education and testing requirements for mortgage professionals; and (3) simplified disclosure forms for consumers. Mr. Ryan also described coordinated efforts by state and federal regulators to develop guidelines for nontraditional and subprime lending and to supervise nondepository mortgage lenders and brokers.

(C) Judith Ripley, Commissioner of DFI, outlined a number of proposals for consideration by the 2008 General Assembly, including legislation to do the following: (1) give the DFI the authority to regulate nondepository first-mortgage lenders; (2) eliminate exemptions from the loan broker statutes that currently exist for certain federally insured loans; (3) increase the current bonding levels for mortgage brokers; (4) require all appraisers and brokers to undergo criminal background checks by the FBI; (5) ensure high standards for licensure and continuing education for appraisers; (6) codify the guidelines for nontraditional and subprime lending adopted by the DFI; (7) hold lenders accountable for the activities of the brokers and appraisers used in their transactions; (8) provide for civil penalties and criminal and civil causes of action against violators of the state's lending laws; (9) require a mortgage document containing certain information, including the names and license numbers of all professionals involved in the transaction, to be filed with the county recorder; (10) require a financial literacy program to be included in the state's K-12 curricula; and (11) require lenders to provide the one-page disclosure document proposed by CSBS.

(D) Sherry Seiwert, Executive Director of the IHCDA, discussed educational solutions to combat mortgage delinquencies and foreclosures. Ms. Seiwert updated the Committee on the IHCDA's efforts to implement HEA 1753 (2007), which authorized the IHCDA to establish a program to provide free mortgage foreclosure counseling to homeowners. Ms. Seiwert announced that the IHCDA would launch the Indiana Foreclosure Prevention Network on October 26, 2007. According to Ms. Seiwert, the Network is designed to provide resources to homeowners facing a crisis that threatens their ability to meet an ongoing mortgage obligation. These homeowners will have access to the Network's resources through a toll-free telephone hotline and a website administered by Momentive Consumer Credit Counseling.

Whenever possible, hotline counselors will assist homeowners over the phone. However, if more extensive assistance is needed, counselors will refer a homeowner to "a certified foreclosure intervention specialist." Serving as intermediaries between homeowners and lenders, the foreclosure intervention specialists will work to obtain forbearance, a refinancing, or a short sale in order to avert foreclosure.

With a targeted public awareness campaign underway, Ms. Seiwert predicted that at least 30,000 homeowners would access the hotline and website during the program's first year. The IHCDA's goal is to save 5,000 Indiana families from foreclosure during this same period.

(E) Christie Gillespie, Executive Director of the Indiana Association for Community Economic Development (IACED), explained IACED's role in training housing counselors to become certified foreclosure intervention specialists for the Indiana Foreclosure Prevention Network. Ms. Gillespie reported that 17 agencies will provide counselors to assist homeowners in resolving mortgage delinquency or foreclosure issues. All of the agencies have sent housing counselors to a series of four trainings sponsored by the IHCDA and coordinated by IACED.

(F) June Lyle, Interim State Director for AARP Indiana, described AARP's efforts to educate its members about avoiding foreclosure and the various types of housing fraud, including home repair fraud. She noted that medical costs often destabilize older people's finances, leaving the elderly with less money for housing expenses.

Ms. Lyle acknowledged that important consumer protections were enacted with the passage of HEA 1753 (2007), which established a program to provide free mortgage foreclosure counseling, and HEA 1717 (2007), which gave the Securities Commissioner increased authority to regulate loan brokers. However, Ms. Lyle urged legislators to do the following to further prevent foreclosures and predatory lending practices: (1) provide additional funding for the mortgage foreclosure counseling program established under HEA 1753; (2) strengthen the Attorney General's ability to investigate suspected mortgage fraud and to enforce existing lending laws; (3) encourage regular information sharing among the agencies that regulate residential real estate transactions; and (4) introduce legislation to enact the proposals recommended by the DFI.

(8) The impact of mortgage fraud and foreclosures on consumers:

(A) David and Phyllis Stinson, a Danville couple assisted by the Secretary of State's Prosecution Assistance Unit (PAU) after being victimized by a mortgage fraud scheme, described their experience to the Committee.

Ms. Stinson explained that in 2004, she and her husband had applied for a loan against the equity in their home, in order to obtain needed income after her husband's heart surgery and subsequent retirement. However, the loan broker they retained had, without their knowledge, falsified their income in applying for a loan on their behalf. This allowed the broker to obtain a loan that was much larger than the Stinsons would otherwise have qualified for. In return for providing a large upfront payment to the Stinsons, the broker had offered to make the loan payments to the lender on the Stinsons' behalf, on the condition that they provide him in advance with two years' worth of loan payments, which he claimed he would put into an escrow account on their behalf. When the broker failed to make payments on the loan as promised, the Stinsons were liable for the amounts owed. However, after paying medical bills and the advance loan payments demanded by the broker, the Stinsons could not afford to make the payments on the loan. In trying to refinance the loan, they discovered that it had been sold three different times. They also discovered that the broker had absconded with the funds they had advanced to him.

Ms. Stinson credited Charles Williams, a PAU investigator, with helping to obtain the arrest of the broker. In addition, Mr. Williams helped the Stinsons work out an arrangement with the lender that allowed them to keep their home. However, Ms. Stinson reported that the couple had to declare bankruptcy along the way and is still working to pay off the debt.

(B) Steven Sharp, Staff Attorney for Indiana Legal Services (ILS) in Bloomington, described his work in defending low-income homeowners in foreclosure cases.

Mr. Sharp reported that many of his clients have defaulted on their loans because the loan originator never analyzed the client's ability to repay the loan. He argued that it is crucial for originators to determine the borrower's ability to make payments based on the borrower's stable sources of income, rather than on temporary or unstable sources of income, such as seasonal compensation or overtime.

Mr. Sharp also suggested that his clients have been harmed by aggressive sales tactics used by lenders and brokers. According to Mr. Sharp, originators are often offered incentives to close loans, and then receive commissions based on the amount of the loan. These originators receive their commissions when the loan closes, regardless of whether the borrower ever makes a single payment on the loan after the closing. As a result, the originator has no incentive to ensure that the loan product is suitable for the borrower based on repayment ability.
Mr. Sharp noted that loan servicing practices contribute to the difficulties faced by his clients. He explained that when loans are constantly sold and assigned, or contracted out to separate servicing companies, borrowers are often forced to deal with remote call centers when attempting to work out payment arrangements with lenders.

Mr. Sharp outlined several measures that could help his clients. While commending the state's efforts to provide consumer counseling, he suggested that borrowers are also in need of legal services, especially at closings and in foreclosure proceedings. Noting that lenders are almost always represented by counsel, he argued that borrowers, who often lack financial acumen, deserve legal representation as well.

Mr. Sharp also described recent efforts in Ohio, Pennsylvania, and North Carolina to protect consumers and hold brokers accountable for the loans they originate. For example, he pointed to a recently enacted North Carolina law that makes a loan broker jointly and severally liable with the lender for issuing a loan that violates the state's mortgage lending act. He also mentioned a Pennsylvania program that provides temporary assistance in the form of "bridge loans" to homeowners who are delinquent on their mortgages due to financial crisis. He noted that Ohio has established a program that allows struggling borrowers to refinance their existing loans into 30-year, fixed rate loans.

Having described the consumer protection measures taken by other states, Mr. Sharp urged the Committee to consider amending Indiana's Deceptive Consumer Sales Act to include certain practices common in the mortgage industry.

V. COMMITTEE FINDINGS AND RECOMMENDATIONS

The Committee received and considered numerous proposals for legislation to be introduced during the 2008 session of the General Assembly. A complete list of the recommendations discussed by the Committee on October 30, 2007, is included with this report as Exhibit 1.

Committee Findings:

Prepayment Penalties:

The Committee finds that prepayment penalties may impose significant financial hardships on borrowers by:

(1) serving as a disincentive for borrowers to refinance loans or otherwise obtain loans with more favorable terms; and
(2) penalizing borrowers for paying down debt more quickly.

However, the Committee also recognizes that prepayment penalties may:

(1) be appropriate for particular loans, or for limited times during the life of a loan; and
(2) help to ensure the availability of credit by protecting the interests of lenders in the loans they issue.

Given the need to weigh the interests of consumers in paying down debt, with the interests of lenders in protecting their investments, the Committee finds that it is appropriate for the General Assembly to further examine prepayment penalties during the 2008 session.

Committee Recommendations:

At its meeting on October 30, 2007, the Committee voted (7-0) to recommend that the following bill be introduced in the 2008 session of the General Assembly:

PD 3402 (Lawson): Makes the following changes to the statute governing the regulation of loan brokers (IC 23-2-5):

(A) Specifies that:

(i) applicants for licensure or registration under the statute must submit fingerprints for a national criminal history background check by the FBI; and

(ii) the Securities Commissioner may not release the results of a national criminal history background check to a private entity.

(B) Allows the Securities Commissioner to use a multistate automated licensing system and repository to process applications for licensure and registration and to check the qualifications and background of applicants.

(C) Specifies that loan brokers are required to safeguard the personal information of borrowers and prospective borrowers.

(D) Prohibits certain actions in connection with a contract for the services of a loan broker.

After considering the proposals set forth in Exhibit 1, the Committee also voted (7-0) to recommend that members of the 2008 General Assembly pursue legislation (or consider pursuing legislation)[1] to do the following:

(1) Require lenders that:

(A) issue first mortgage loans; and

(B) are not supervised financial organizations (as defined in IC 24-4.5-1-301(20));

to be regulated and licensed under the Uniform Consumer Credit Code (IC 24-4.5).

(2) Consider increasing the amount of the bond ($50,000 under current law (IC 23-2-5-5(e)) that a licensed loan broker must maintain with the Securities Commissioner to secure the payment of damages to any person aggrieved by any violation of the loan broker statute (IC 23-2-5) by the licensee.

(3) Require all applicants for initial:

(A) licensure or certification as a real estate appraiser (IC 25-34.1-8; Real Estate Appraiser Licensure and Certification Board);

(B) licensure as a loan broker (IC 23-2-5; Securities Commissioner); or

(C) registration as an originator or a principal manager (IC 23-2-5; Securities Commissioner);

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[1]With respect to certain issues, the Committee recommended that members of the 2008 General Assembly "consider" pursuing the suggested proposals. These proposals are so designated in the listed recommendations, and reflect a consensus by the Committee that the suggested proposals need further development or research.

to submit fingerprints for a national criminal history background check by the FBI.

(4) Provide that an applicant for licensure, certification, or registration shall pay any fees or costs associated with a criminal history background check, including costs for any required fingerprints.

(5) Provide that if the Securities Commissioner seeks a criminal history background check at the time of renewal of a license or certificate of registration, the Commissioner must consider:

(A) the resources and staffing available to the State Police to process or conduct a criminal background check in a timely manner;
(B) the length of time that has elapsed since the most recent criminal background check was conducted with respect to the applicant for renewal; and
(C) the financial or administrative burdens that a criminal background check will place on the applicant for renewal.

(6) Provide that an applicant for a renewal licensure or certification from the Real Estate Appraiser Licensure and Certification Board may not be required to undergo a national criminal history background check, unless the applicant did not undergo a national criminal history background check as part of the applicant's initial application for licensure or certification.

(7) Include in the Uniform Consumer Credit Code (IC 24-4.5-3) the mortgage loan underwriting standards that are set forth in:

(A) the Interagency Guidance on Nontraditional Mortgage Product Risks; and
(B) the Statement on Subprime Mortgage Lending;

issued by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Lenders, and adopted by the Department of Financial Institutions and the Office of the Secretary of State.

(8) Allow:

(A) the imposition of civil penalties; and
(B) civil and criminal causes of action;

for fraudulent lending practices and violations of state lending laws. Provide monetary penalties that are significant enough to deter these practices and violations. Provide that these remedies are available to consumers, regulators, and courts.

(9) Consider requiring that any civil penalties imposed by:

(A) the Indiana Real Estate Commission; or

(B) the Real Estate Appraiser Licensure and Certification Board;

under IC 25-1-11-12 be deposited in the investigative fund established by IC 25-34.1-8-7.5 for use by the Attorney General and the Professional Licensing Agency in conducting investigations and taking enforcement actions against real estate and appraisal fraud. (Current law provides that such civil penalties are deposited in the State General Fund.)

(10) Amend IC 24-9-8 to enhance the criminal penalty that may be imposed for certain violations of IC 24-9 (Home Loan Practices). (Current law provides that a knowing or intentional violation of IC 24-9 is a Class A misdemeanor.)

(11) Amend IC 24-5-0.5 (Deceptive Consumer Sales) to enhance the penalties that may be imposed by the Attorney General under IC 24-5-0.5 for an act that constitutes a violation of IC 24-9 (Home Loan Practices).

(12) Consider requiring that mortgage closing documents include a one-page document that must be signed by the borrower and that includes the following information:

(A) Sales price.

(B) Information on the homestead and mortgage property tax exemptions.

(C) The names and license or registration numbers of all parties involved in the mortgage transaction, to the extent determinable.

Consider requiring this document to be provided in connection with both purchase-money loans and refinancings.

(13) Consistent with federal law, require lenders to provide to prospective borrowers certain essential information, in a summary format, concerning the loan. For an adjustable rate mortgage, the information provided must include:

(A) the fully indexed rate, or the maximum interest rate that could apply to the loan; and

(B) the maximum monthly payment that could be required under the loan;

at any time during the life of the loan.

(14) Recommend that school corporations include a financial literacy program in curricula for primary and secondary students.

(15) Provide that if a borrower's mortgage debt is forgiven by a lender:

(A) upon sale of the mortgaged property in a foreclosure proceeding; or

(B) when the mortgaged property is sold for an amount less than the amount of the outstanding mortgage;

the debt forgiven by the lender may not be treated as income to the borrower for purposes of the adjusted gross income tax (IC 6-3-1 through IC 6-3-7). Provide that the exemption applies to debt forgiveness with respect to both purchase-money loans and refinancings.

(16) Amend Indiana's statutes governing mortgage foreclosures (IC 32-29-7; IC 32-29-8; IC 32-30-10; IC 32-30-12) to expedite the foreclosure process, while protecting the interests of homeowners.

(17) Require a lender that holds a mortgage loan to provide a payoff balance and respond to short sale offers for the mortgaged property within a specified period of time.

WITNESS LIST

Gary Avery	Co-Chair, Indiana Mortgage Fraud and Foreclosure Prevention Task Force; Vice President, First Republic Mortgage Corporation
Chris Beaumont	Vice President, Government Affairs, Indiana Credit Union League
Chuck Cohen	Sergeant, Criminal Intelligence Section, Indiana State Police
O. Wayne Davis	Securities Commissioner, Office of the Indiana Secretary of State
Thomas Dinwiddie	Wooden & McLaughlin
Donna Eide	Co-Chair, Indiana Mortgage Fraud and Foreclosure Prevention Task Force; former Assistant United States Attorney, Southern District of Indiana
Christie Gillespie	Executive Director, Indiana Association for Community Economic Development
Mike Hannigan	President, The Hannigan Company, LLC
Sally Johnson	Government Affairs Director, Indiana Association of Realtors
Matt Light	Deputy Attorney General, Consumer Protection Division, Office of the Attorney General
June Lyle	Interim State Director, AARP Indiana
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Barry Wood	Director of Assessment, Department of Local Government Finance