

California Association of Mortgage Brokers



TO: The Honorable Ted Lieu, California State Assembly
FROM: Ed Smith, Jr., Vice President of Government Affairs & Industry Relations
SUBJECT: AB 260 (Lieu)
POSITION: Oppose Unless Amended
DATE: March 17, 2009

On behalf of the California Association of Mortgage Brokers (CAMB), we respectfully oppose unless amended, AB 260 (Lieu), related to mortgage lending.

CAMB is a nonprofit professional trade association consisting of licensed real estate brokers, salespersons, and affiliated lenders whose primary business is assisting consumers in obtaining residential and commercial real estate financing. Mortgage brokers originate the majority of all residential mortgages in California. CAMB Members subscribe to a Code of Best Practices and Ethics, pledging to uphold the highest standards of professional conduct, honesty and integrity, and to full compliance with applicable laws. CAMB opposes AB 260 unless amended.

While CAMB applauds both the intent of AB 260, increased protection for mortgage borrowers, and the tremendous amount of effort that moved forward and improved the bill since its introduction as AB1830 in January of 2007, CAMB believes that several remaining flaws will not only nullify the bill's positive components, but will end up harming California businesses and California consumers by preventing state-licensed loan originators from competing with those holding federal licenses:

1. The proposed statutory fiduciary duty's economic interest test is unreasonably vague. It will leave California licensed loan originators struggling to determine how to comply;
2. The anti-steering clause of the proposed higher-priced loan regulation fails to offer any guidance on the definition of "high-cost" loan used within. This will lead to a reduction in consumer options as California licensed originators necessarily adopt a defensive posture;
3. The proposed attorney fee clause will tend to invite lawsuits on the flimsiest of grounds, significantly increasing the cost of doing business for California licensed originators without providing real benefit to consumers;
4. The safe harbors within AB 260, designed to allow brokers an opportunity to correct certain unintended errors before facing liability, cannot be utilized because they require a broker to offer to change loan terms after a loan has funded; a broker, by definition, has no authority or ability to alter post-close loan terms;

1. Proposed "California Only" Fiscal Fiduciary Duty

Department of Real Estate licensed mortgage brokers in California currently owe their borrowers a common law form of fiduciary duty:

The California Association of Mortgage Brokers promotes the highest standards of professional and ethical conduct, among which are expert knowledge, accountability, fair dealing, and service to our clients and our community.

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North Los Angeles County

Greater Northstate

Orange County

Greater Sacramento Area

San Diego

San Diego North County

San Francisco Peninsula

San Gabriel Valley

San Joaquin

Silicon Valley

Southern Los Angeles County

“A mortgage loan broker is customarily retained by a borrower to act as the Borrower's agent in negotiating an acceptable loan. All persons engaged in this business in California are required to obtain real estate licenses. (Bus. & Prof.Code, §§ 10130 and 10131, subd. (d).) Thus, general principles of agency (Civ.Code, §§ 2228 and 2322, subd. 3) combine with statutory duties created by the Real Estate Law (see Bus. & Prof.Code, § 10176, subds. (a), (i)) to impose upon mortgage loan brokers an obligation to make a full and accurate disclosure of the terms of a loan to borrowers and to act always in the utmost good faith toward their principals.” (24 Cal.3d 773, 23748, *Wyatt v. Union Mortgage Co.*)

Beyond *Wyatt*, fiduciary duty has been generally interpreted to require four underlying duties: good faith, loyalty, due diligence and disclosure. AB 260 proposes a new statutory fiduciary duty definition that would require the mortgage broker to “place the economic interest of the borrower ahead of his or her own economic interest.” (*AB 260, pg6, ll 31-32.*) This definition is in conflict with opinions that indicate that at the point of fee negotiation between a principal and agent there is no fiduciary duty; the agent is acting solely for himself (see *Holzman v. Blum*, Maryland 726 A2d, 1999.) If the AB 260 language is interpreted by the black letter, a broker would be estopped from collecting a fee for services rendered, because to do so would arguably place their economic interest ahead of the borrower. If a less stringent interpretation is risked, brokers and regulators will be forced to guess the location of the threshold beyond which the size of the fee becomes a breach of the duty. No guidance is offered by this legislation.

CAMB supports a broker fiduciary duty to their clients, but believes the fiscal fiduciary duty proposed by AB 260 is void for vagueness, unworkable in a business environment, and unfair to California small business. Local California businesses that operate under state licenses (the only originators bound by this legislation) will be forced to take a defensive position that reflects the risk associated with an obligation to perform an ill-defined duty, while federal institutional lenders will be able to proceed about their business duty-free.

CAMB supports a universal fiduciary duty for all loan originators akin to the definition offered by the California Supreme Court in *Wyatt*, but not the fiscal definition in this bill.

2. Failure to Define High-Cost Loan as it Relates to Steering

AB 260 proposes that:

“ . . . a mortgage broker who provides mortgage brokerage services shall not steer, counsel, or direct a borrower to accept a loan at a higher cost than that for which the

borrower could qualify based on the loans offered by the persons with whom the broker regularly does business.” (AB 260, pg 9, ll.18-22.)

This clause fails to clearly define how cost is to be measured and fails to recognize how the mortgage transaction works, i.e., borrowers typically qualify for a range of rates — not a single rate — which vary contingent on the fees they are willing to pay: higher rates cost less, lower rates cost more. In actual dollars, a lower interest rate loan with low payments but higher upfront fee may cost less if it is kept for a longer period of time, whereas a higher interest rate loan with slightly higher payments but no upfront fees may cost less if kept for a relatively short time. Both have their place depending upon a given consumer’s financial plans and goals. CAMB supports reasonable anti-steering legislation, but feels that this clause, if enacted as written, will serve only to do away with consumers’ ability to obtain financing that suits their needs without providing effective protection from the abuse at which the statute is aimed.

3. The Proposed Attorney Fee Clause will Invite Lawsuits

For even minor or technical violations, the bill will encourage lawsuits against California licensed originators and can result in the award of large amounts of fees and costs when there are little or no actual damages. Courts will spend large amounts of time even debating who 'prevailed' in given cases. Under AB 260, attorney’s fees can be awarded in basic, common law tort actions against real estate licensees. This is not an academic point, instead representing a very basic departure from established tort law. The language is inconsistent with current provisions of the 'covered loan law' in the Financial Code, and inconsistent with negligence actions against other professionals.

4. Absolute Inability of Broker to Perform Mandated Duty

The safe harbors offered in AB 260 are a realistic approach to offering mitigation to well-meaning brokers who suffer errors or omissions, but both harbors dictate that the broker must offer the consumer an option that brokers cannot deliver. To avoid liability, the broker must offer to “change the terms of the loan in a manner beneficial to the borrower” (AB 260, pg 10, ll. 15-16.) A broker, by definition, has neither the authority nor the means to re-write loan terms. A broker can request that a lender modify a loan, but has no power to demand such. If a lender is unable or refuses to assist, a broker will not be able to comply. CAMB agrees with the need to offer a safe harbor to well-meaning brokers, but given the attached condition precedent which cannot be performed, such a harbor does not exist in this bill. CAMB urges that sections which offer this option, (h)(1)(C,D) on page 10, and (h)(2)(iii) and (h)(2)(iv) on page 10, be stricken.

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Conclusion

CAMB believes that AB 260 will place California licensees at a competitive disadvantage, forcing them to offer fewer products and pricing options all at greater personal economic risk; if they collect the fees required to stay in business they must fear attacks through attorney-fee lawsuits that seek to discover the outer bounds of the new fiscal fiduciary duty. California licensees must hope that the definition of higher cost loan they choose to follow is the same as the intended but undefined one, or expensive attorney-fee lawsuits will expose them as minor violators. Finally, well-intentioned California licensees will not be able to take advantage of the bill's safe harbors because they are powerless to do so; all at a time when error and omission policy premiums are skyrocketing, if such insurance is available at all.

Under AB 260, many California small businesses will close, competition will diminish, and California consumers will suffer.

CAMB wishes to offer the authors of this bill gratitude for their tremendous effort and polishing of this bill over the past two years. However, for the reasons stated above, CAMB currently opposes AB 260 (Lieu) unless amended.

We appreciate your consideration of our suggestions.

cc: Aaron Read, Aaron Read & Associates
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