

# Regulatory Analysis Form

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**(1) Agency**

Department of Banking

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3-43

INDEPENDENT REGULATORY  
REVIEW COMMISSION

IRRC Number: 2620

**(3) Short Title**

Proper Conduct of Lending and Brokering in the Mortgage Loan Business

**(4) PA Code Cite**

10 Pa. Code Chapter 46

**(5) Agency Contacts & Telephone Numbers**

Primary Contact: Robert C. Lopez, Deputy Chief Counsel,  
717-787-1471

Secondary Contact: Carter D. Frantz, Chief Counsel,  
717-787-1471

**(6) Type of Rulemaking (check one)**

- Proposed Rulemaking
- Final Order Adopting Regulation
- Final Order, Proposed Rulemaking Omitted

**(7) Is a 120-Day Emergency Certification Attached?**

- No
- Yes: By the Attorney General
- Yes: By the Governor

**(8) Briefly explain the regulation in clear and nontechnical language.**

The final-form regulation defines the proper conduct of lending and brokering in the mortgage loan business in Pennsylvania for licensee lenders and brokers under 7 Pa.C.S. § 6101 *et seq.* (relating to mortgage loan industry licensing and consumer protection)(the "Mortgage Act") and all licensees under the Consumer Discount Company Act (the "CDCA")(jointly the "Acts"). The regulation establishes for the aforementioned licensees under the Acts (the "Licensees") a standard for lending and brokering mortgage loans in Pennsylvania and prohibits certain improper conduct during the mortgage loan process. In particular, the regulation requires Licensees to perform an analysis of a borrower's ability to repay an offered mortgage loan and provide additional disclosures concerning important loan terms that affect a borrower's short and long term payments.

**(9) State the statutory authority for the regulation and any relevant state or federal court decisions.**

1. 7 Pa.C.S. § 6138(a)(4).
2. Section 12 of the Consumer Discount Company Act (7 P.S. § 6212).

## Regulatory Analysis Form

**(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.**

No.

**(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?**

The final-form regulation addresses improper brokering and lending practices occurring in the mortgage loan business as a result of the proliferation of complex mortgage loan products and a decline in underwriting standards for mortgage lending. Such practices include: not properly considering and analyzing whether or not borrowers can reasonably repay an offered mortgage loan, failing to appropriately inform borrowers of important loan terms that could affect their ability to satisfy payment obligations and various other practices that taint the process of originating, processing and closing mortgage loans. The improper practices addressed by the regulation have the potential to harm not only borrowers, but all parties to the mortgage loan process, including, lenders, brokers, appraisers and real estate agents.

**(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.**

The primary general welfare risk associated with nonregulation is the continued practice of offering and providing mortgage loan products to borrowers without conducting a reasonable analysis of whether or not the potential borrower has the ability to repay the offered mortgage loan. Borrowers who are not able to repay their mortgage loans face the ultimate risk of foreclosure on their residence. Failure to promulgate the regulation will also allow Licensees to operate without clear guidance from the Department as to what improper mortgage lending and brokering practices are in Pennsylvania.

**(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)**

The primary beneficiaries of the regulation are borrowers seeking mortgage loans from Licensees. Licensees will be required to perform a reasonable analysis as to whether or not a borrower can afford to repay an offered mortgage loan. Borrowers will also benefit from the distribution of additional information regarding specific loan terms that have a direct bearing on the short and long term payment obligations under the offered mortgage loan. Furthermore, borrowers will benefit from the clear prohibition of practices that place them at a disadvantage in the loan process and increase the risk of unknowingly entering into excessively onerous financial loan obligations.

Licensees will also benefit from the clear and explicit prohibitions and requirements regarding the proper conduct of brokering and lending in the mortgage loan business. The regulation should also benefit Licensees by leading to fewer secondary market "buy-backs" of sold loans and an increased confidence of Pennsylvania borrowers in Licensees as a result of borrowers knowing that the Licensees are required to make a reasonable determination of their ability to repay any offered loan.

## Regulatory Analysis Form

**(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)**

The Department anticipates that certain Licensees will initially be adversely affected by the regulation to the extent they are required to change current business practices that would no longer be appropriate under the regulation, *i.e.* cost of compliance. These costs would primarily result from changing business practices to include a reasonable analysis of a borrower's ability to repay an offered mortgage loan and providing borrowers with an additional one-page disclosure form prescribed by the Department during the mortgage loan process. The remaining provisions of the regulation are prohibitions and requirements that are not expected to significantly affect Licensees adversely. The Department believes that any adverse effects will be experienced primarily in the initial effective period of the regulation. All licensee lenders and brokers under the Mortgage Act and all licensees under the CDCA will be covered by the regulation and will potentially be adversely affected (currently, 4,756 licensees).

**(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)**

All licensee lenders and brokers under the Mortgage Act and all licensees under the CDCA. Currently, this amounts to:

- 4,718 licensees under the Mortgage Act\*
- 38 licensees under the CDCA

Branch licensees are required for each separate branch location of Licensees. Currently, total branch licenses issued by the Department are as follows:

- 3,075 branch licenses under the Mortgage Act\*
- 388 branch licenses under the CDCA

\*The figure given for licensees under the Mortgage Act are anticipated numbers based upon the number of licensees under the two statutes the Mortgage Act is replacing. Current licensees under the Mortgage Bankers and Brokers and Consumer Equity Protection Act, 63 P.S. § 456.301 *et seq.*, and the Secondary Mortgage Loan Act, 7 P.S. § 6101 *et seq.*, must reapply for licenses under the Mortgage Act when effective. Additionally, the Mortgage Act creates a new class of licensee, loan originator, which was not in existence under the MBBCEPA and SMLA. The Department will amend the regulation to address loan originators under the regulation.

**(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.**

The final-form regulation was extensively vetted over the past three years with industry associations and representatives as well as consumer organizations and representatives. The initial vetting began in 2006 and culminated in a public hearing and request for written comment that was noticed in the *Pennsylvania Bulletin* as an Advanced Notice of Proposed Rulemaking on July 29, 2006. After the public hearing in September of 2006, the Department continued to discuss the regulation and receive input from the public and interested parties up until the time of the submission of the proposed regulation for promulgation in July of 2007.

The following is a list of entities that either testified and/or submitted comments during the advanced notice period:

- Armstrong Financial Services Company

- Association of Community Organizations for Reform Now (ACORN)
- Fairway Consumer Discount Company
- K. Tucker Landon, Attorney
- Mortgage Bankers Association of Pennsylvania
- Pennsylvania Association of Mortgage Brokers
- Pennsylvania Bankers Association
- Pennsylvania Credit Union Administration
- Pennsylvania Financial Services Association
- Pennsylvania Retailers' Association
- Pittsburgh Community Reinvestment Group
- Responsible Mortgage Bankers Coalition
- State Board of Certified Real Estate Appraisers
- TBI Mortgage Company
- United Neighborhood Centers
- Kenneth J. Noll, Noll Farms
- Housing Alliance of Pennsylvania
- Mary A. Schmidt, Lost Acres Farm
- Community Action Committee of Lehigh Valley
- Community Legal Services
- Unemployment Information Center
- Darnell Tanksley, Consumer
- Unemployment Project and Unemployment Information Center
- John Ivey, Consumer

**(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.**

The Department acknowledges that Licensees will likely incur costs associated with compliance with the regulation during an initial compliance period; however, the extent of such costs cannot be reasonably determined. The costs associated with compliance will necessarily vary among Licensees depending on numerous factors, including the following:

(1) The extent that current business practices deviate from what is required under the regulation. Licensees currently operating with strong internal controls and underwriting programs would not likely need to significantly alter their current business practices. However, Licensees that have weak or nonexistent internal controls or underwriting programs will need to significantly alter current business practices and, in some instances, may need to retain consultants.

(2) The ability of Licensees to incorporate an additional disclosure form in their loan process. Depending upon the size of the licensee and the method by which disclosures are already provided, costs associated with modifying automated electronic disclosure systems or programs may be incurred.

To mitigate compliance costs and assist Licensees, the Department intends to work with Pennsylvania continuing education suppliers to develop and implement specific courses to address compliance under the regulation (Licensees under the Mortgage Act are required to attend continuing education courses as a condition of licensure). The Department also intends to provide compliance and examination workshops, informational packets and additional materials to its licensees. Furthermore, in April of 2007, the Department sent to all Licensees Guidance on Nontraditional Mortgage Products which will greatly assist Licensees by providing a framework for revising their business practices in a manner that is consistent with the purpose of the regulation. The Guidance on Nontraditional Mortgage Products has been adopted by 44 other states. Lastly, it is anticipated that professional associations for mortgage brokers and lenders will assist its members in any required transition.

## Regulatory Analysis Form

**(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.**

While the Department believes that there will be long term savings to local governments in the form of decreased housing foreclosures and the associated costs, such savings are unquantifiable at this time. There are no anticipated costs to local governments.

**(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.**

While the Department believes that there will be long term savings to state governments in the form of decreased housing foreclosures and the associated costs, such savings are unquantifiable at this time. There are no anticipated costs to state government.

## Regulatory Analysis Form

(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

|                             | Current FY<br>Year        | FY +1<br>Year | FY +2<br>Year | FY +3<br>Year | FY +4<br>Year | FY +5<br>Year |
|-----------------------------|---------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>SAVINGS:</b>             | \$                        | \$            | \$            | \$            | \$            | \$            |
| Regulated Community         | None.                     |               |               |               |               |               |
| Local Government            | Unable to be determined.  |               |               |               |               |               |
| State Government            | Unable to be determined.  |               |               |               |               |               |
| <b>Total Savings</b>        |                           |               |               |               |               |               |
| <b>COSTS:</b>               |                           |               |               |               |               |               |
| Regulated Community         | Unable to be determined.  |               |               |               |               |               |
| Local Government            | None.                     |               |               |               |               |               |
| State Government            | None.                     |               |               |               |               |               |
| <b>Total Costs</b>          |                           |               |               |               |               |               |
| <b>REVENUE LOSSES:</b>      |                           |               |               |               |               |               |
| Regulated Community         | Unable to be determined.* |               |               |               |               |               |
| Local Government            | None.                     |               |               |               |               |               |
| State Government            | None.                     |               |               |               |               |               |
| <b>Total Revenue Losses</b> |                           |               |               |               |               |               |

\*Compliance with the regulation will appropriately lead to decreased gross revenue for those Licensees who currently provide loans to borrowers without due regard to the borrowers' ability to repay. These Licensees will no longer be permitted to provide mortgage loans to borrowers without reasonably considering whether or not the borrower has the ability to repay the offered loan as required by the regulation. These losses are not able to be quantified by the Department.

(20a) Explain how the cost estimates listed above were derived.

The Department is unable to determine or estimate the costs of compliance with the regulation. Please refer to the Department's answer to Question No. 17.

## Regulatory Analysis Form

**(20b) Provide the past three year expenditure history for programs affected by the regulation.**

| Program         | FY -3 | FY -2 | FY -1 | Current FY |
|-----------------|-------|-------|-------|------------|
| Not applicable. |       |       |       |            |
|                 |       |       |       |            |
|                 |       |       |       |            |
|                 |       |       |       |            |

**(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.**

Although the Department is not able to determine the costs to Licensees, the Department believes that any initial costs incurred as a result of compliance are greatly outweighed by the benefits of the regulation. The overall design of the regulation is intended to prevent borrowers from being placed into loans that mortgage lenders and brokers know, or reasonably should know, borrowers will not be able to repay. The regulation also explicitly prohibits practices that put borrowers at a higher risk of extreme financial difficulty and foreclosure upon their residence.

**(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.**

There were no nonregulatory alternatives considered because the Department seeks to put into place requirements regarding the proper conduct of lending and brokering under the Mortgage Act and the CDCA that have the force and effect of law.

**(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.**

The Department initially considered issuing a statement of policy regarding proper brokering and lending in the mortgage loan business. The statement of policy was dismissed because the Department determined that in order to achieve its policy goal of protecting consumers and providing clear guidance to Licensees, it is necessary to put into place prohibitions and requirements that have the force and effect of law.

## Regulatory Analysis Form

**(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.**

The federal government does not directly regulate or license non-depository mortgage lenders and mortgage brokers, so there is no corresponding licensing law or regulation to directly compare with the regulation. Regarding the ability to repay analysis requirement, the federal Home Ownership and Equity Protection Act ("HOEPA") does require an ability to repay analysis for certain loans that meet its threshold requirements. The ability to repay analysis required by HOEPA is comparable to the analysis required by the regulation; however, the regulation explicitly requires verification of income and fixed expenses. The Department believes that only a small percentage of Licensees originate loans covered by HOEPA because of the high thresholds and additional requirements of the act. Regarding disclosures, the Truth in Lending Act and Real Estate Settlement Procedures Act require certain disclosures be given to borrowers by Licensees. The Department believes that the one-page disclosure form for key terms affecting payments under the offered loan serves to complement the disclosures required under federal law.

**(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?**

The regulation is more rigorous than the laws governing non-depository mortgage lenders and mortgage brokers in other states primarily due to the ability to repay analysis requirement. Locally, of the six states contiguous to Pennsylvania, three have laws with ability to repay provisions. Maryland and New York have requirements for an ability to repay analysis for a specific type of loan, commonly referred to as "high-cost home loans" or "covered loans" (Pennsylvania also has an ability to repay analysis for "covered loans," which are exempted from coverage under the regulation). New York's high-cost home loan ability to repay analysis is similar to the regulation in that it requires verification of income. Ohio recently enacted a law that requires an ability to repay analysis that is not limited to a certain type of loan. Delaware, New Jersey and West Virginia have no ability to repay analysis requirement. Nationally, approximately 17 states have some form of an ability to repay analysis for high-cost or covered home loans. Georgia, Minnesota and the Virgin Islands have enacted laws that require an ability to repay analysis comparable to the regulation and which are not limited to a specified set of loans. The regulation generally is broader in scope than most states by covering all loans and explicitly requiring verification of income/fixed expenses.

The remaining provisions of the regulation are not believed by the Department to be appreciably more onerous or stricter than those of other states.

The Department does not believe that Pennsylvania would be put at a competitive disadvantage with other states as a result of the regulation. Due to the recent collapse of several large non-depository mortgage lenders and the turmoil currently being experienced in the national economy as a result of the collapse of the housing and mortgage markets, an ability to repay analysis has nationally come to the forefront of discussions on how to prevent future instability for borrowers and the industry. For example, other states within the nation are moving toward similar requirements in their respective regulatory schemes. As of this date, 44 states (including Pennsylvania) have adopted the Conference of State Banking Supervisors ("CSBS") and American Association Residential Mortgage Regulators ("AARMR") Guidance on Non-Traditional Mortgage Products (the "CSBS/AARMR Guidance"). The CSBS/AARMR Guidance contains within it an ability to repay analysis comparable to the analysis within the Department's regulation. Additionally, the CSBS/AARMR Guidance parallels the guidance issued by the federal banking regulators to federal and state depository institutions across the nation. The regulation primarily differs from the guidance in its application to prime loans.

Regulatory Analysis Form

**(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.**

On September 12<sup>th</sup> and 13<sup>th</sup> of 2006, the Department held a public hearing regarding the regulation and a proposed statement of policy in order to receive written and oral comments. There are no further public hearings or informational meetings scheduled.

**(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.**

Yes. Section 46.2(e)(5) of the regulation requires Licensees to maintain in borrower loan files the documentation and information supporting the Licensees' ability to repay analysis. Section 46.2(d) requires the retention of executed disclosure forms prescribed by the Department under Section 42.2(b).

**(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.**

The regulation does not have any such special provisions; however, the disclosure form prescribed by the Department in subsection (b) will also be made available by the Department in Spanish.

**(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?**

The anticipated effective date of Subsections (b) through (i) of the regulation will be 90 days from publication of the final approved regulation in the *Pennsylvania Bulletin*. All remaining provisions of the regulation will be effective immediately upon publication.

**(31) Provide the schedule for continual review of the regulation.**

The regulation will be continually reviewed by the Department staff.

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WITH THE LEGISLATIVE REFERENCE BUREAU

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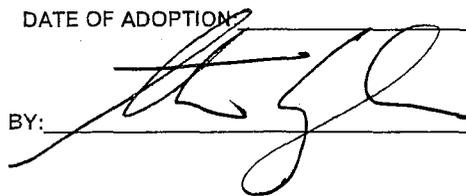
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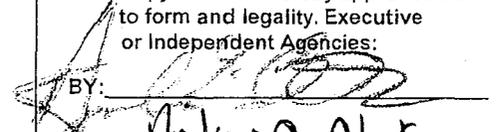
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TITLE: Secretary of Banking  
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BY:   
Andrew C. Clark  
SEP 16 2008

DATE OF APPROVAL

(Deputy General Counsel)  
(~~Chief Counsel, Independent Agency~~)

(Strike inapplicable title)

Check if applicable. No  
Attorney General approval or  
objection within 30 days  
after submission.

NOTICE OF FINAL FORM RULEMAKING  
DEPARTMENT OF BANKING  
BUREAU OF CONSUMER CREDIT AGENCIES  
PROPER CONDUCT OF LENDING AND BROKERING IN THE MORTGAGE LOAN BUSINESS  
[10 PA. CODE CH. 46]

## FINAL RULEMAKING

### DEPARTMENT OF BANKING

#### TITLE 10 – BANKS AND BANKING

#### DEPARTMENT OF BANKING

#### [10 PA. CODE CH. 46]

### **Notice of Final Rulemaking; Regulation Regarding the Proper Conduct of Lending and Brokering in the Mortgage Loan Business**

The Commonwealth of Pennsylvania Department of Banking (the “Department”), under its authority under 7 Pa.C.S. § 6138(a)(4) and Section 12 of the Consumer Discount Company Act (7 P.S. § 6212), adopts Chapter 46 (relating to the proper conduct of lending and brokering in the mortgage loan business) to read as set forth in Annex A.

#### *Purpose of Final Rulemaking*

The Department is adopting this regulation because in the past decade the mortgage loan business has significantly increased in complexity and competitiveness, resulting in a drastically changed borrowing landscape. Unfortunately, because of this complexity and competitiveness, borrowers may not understand the loan products offered to them or the process of obtaining a loan. The Department also believes that there are individuals and entities in the mortgage loan business who take advantage of borrowers by placing them in loan products they are not reasonably capable of repaying. Therefore, the Department has adopted this regulation to govern the proper conduct of lending and brokering to persons and entities operating in the mortgage loan business under 7 Pa.C.S. § 6101 *et seq.* (relating to mortgage loan industry licensing and consumer protection) (the “Mortgage Act”) and the Consumer Discount Company Act, 7 P.S. § 6201 *et seq.* (jointly referenced hereafter as the “Acts”).

#### *Explanation of Final Regulatory Requirements*

This final rulemaking provides rules for the proper conduct of lending and brokering in the mortgage loan business for licensee brokers and lenders under the Mortgage Act and all licensees under the CDCA.

Section 46.2(a) addresses licensee conduct when advertising by specifically prohibiting false or misleading advertising.

Sections 46.2(b) through (f) require licensees to issue a one-page disclosure form prescribed by the Department within three business days after the application is received or prepared by the licensee. The form will disclose: (1) if the lender providing the loan will escrow the applicable taxes and hazard insurance; (2) if the licensee is a lender with the ability to directly lock-in a loan interest rate; (3) whether the loan contains a variable interest rate or balloon payment feature; (4) whether the loan includes a prepayment

penalty and (5) whether the loan has a negative amortization feature. Licensees are also required to have applicants sign and date the disclosure form, retain the disclosure form for their records and re-issue the disclosure form if the licensee knows or reasonably should know the initial disclosure form is inaccurate.

Section 46.2(g) requires licensees to perform an ability to repay analysis when offering a loan to applicants. Licensees must reasonably determine, based upon the documents and information provided, that an applicant will have the ability to repay the offered loan in accordance with the loan terms and conditions by final maturity at the fully indexed rate, assuming a fully amortized repayment schedule. Additionally, licensees: (1) are required to verify and document the income and the fixed expenses of the applicants; (2) are not permitted to primarily rely upon the sale or refinancing of the applicants' loan collateral to repay the loan; and (3) may not ignore facts or circumstances that it knows or reasonably should know would indicate that the applicant does not have the ability to repay the offered loan. Licensees are permitted to consider other factors in addition to income and fixed expenses when performing the ability to repay analysis and licensees are only required to verify and document the income that the applicant intends to rely upon in repaying the loan. Lastly, the subsection sets forth a presumption of ability to repay for certain loans and provides a framework for an analysis of loans with balloon payment features.

Section 46.2(h) exempts reverse mortgage products from certain regulation subsections that are inconsistent with the features of a reverse mortgage loan.

Section 46.2(i) addresses the continuing responsibility of licensees in performing the ability to repay analysis when there is a material change in facts or circumstances that a licensee knows or reasonably should know would substantially affect the applicant's ability to repay the offered loan.

Section 46.2(j) sets forth a series of loan transaction prohibitions addressing specific conduct of licensees that is prohibited.

Section 46.2(k) requires licensee lenders to fund closed loans and prohibits licensees from delaying or failing to fund a loan based upon post-closing underwriting or quality control. A licensee lender may refuse to fund a closed loan only if there is fraud committed by the applicant. In any administrative action brought by the Department under this subsection, a licensee may raise applicant fraud as an affirmative defense; however, the subsection does not relieve or limit the liability of a licensee against any claims of borrowers based upon a refusal or failure to fund a loan based upon an allegation of fraud.

Section 46.2(l) requires licensees, upon request, to provide an applicant or an authorized representative of the applicant with copies or originals of documents associated with the loan transaction, so long as the licensee is permitted to under state and federal law and has the documents in its possession.

Section 46.2(m) requires a licensee that holds or services a loan to provide a borrower with pay-off statements or statements of mortgage reinstatement, as applicable, within seven business days of a request by a borrower or authorized representative of the borrower.

Section 46.3 provides that violations of the regulation are considered violations of the Acts. The section also provides that if a loan is made in good faith in conformity with an interpretation of this chapter by the Department or the courts of this Commonwealth, no penalty for a violation shall apply, notwithstanding the relied upon interpretation may subsequently change.

### ***Summary of Major Comments and Responses on the Proposed Rulemaking***

Pursuant to section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on July 5, 2007, the Department submitted a copy of the proposed rulemaking and a copy of the Regulatory Analysis Form to the Independent Regulatory Review Commission ("IRRC") and the Chairmen of the House Commerce Committee and the Senate Committee on Banking and Insurance. A copy of this material is available to the public upon request. Notice of proposed rulemaking was published in the *Pennsylvania Bulletin* on July 31, 2007.

The Department received over 50 comments to the proposed regulation. The Department prepared a Comment and Response Document, a copy of which is available on the Department's website at [www.banking.state.pa.us](http://www.banking.state.pa.us). The following is a discussion of the major comments received during the public comment period.

#### *Coverage of the regulation regarding subsidiaries of federal and state-chartered banking institutions.*

Under the Mortgage Act, subsidiaries of federal and state-chartered banks are statutorily exempted from coverage and, accordingly, from the regulation also. Under the CDCA, although the plain language does not exempt subsidiaries of federal and state-chartered banks, the Department recognizes federal preemption as a result of cases such as Watters v. Wachovia Bank, N.A., U.S., 127 S.Ct. 1559, 167 L.Ed.2d 389, 75 USLW 4167 (2007). Therefore, the Department will not enforce or administer the CDCA against entities that set forth a valid claim of federal preemption.<sup>1</sup> The Department also will not enforce or administer the CDCA against subsidiaries of state-chartered banks that have availed themselves of similar treatment through the parity provisions of the Banking Code of 1965, 7 P.S. § 201(c).<sup>2</sup>

As to affiliates of federal and state-chartered banks, the Mortgage Act and the CDCA do not provide exemptions for such entities and the Department is not aware of any assertion or ruling of preemption regarding these entities. Therefore, the regulation

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<sup>1, 2</sup> The Department took the same position under the precursors to the Mortgage Act, Chapter 3 of the Mortgage Bankers and Brokers and Consumer Equity Protection Act, 63 P.S. § 456.101 *et seq.*, and the Secondary Mortgage Loan Act, 7 P.S. § 6601 *et seq.*

will apply to such affiliates. The Department believes that the exclusion of such entities would seriously hinder the Department's efforts to address improper lending practices in Pennsylvania by creating a significant regulatory vacuum, which would lead to risk and exposure to Pennsylvania borrowers. The Department is also concerned that by exempting affiliates, a relatively easy method for evasion of the regulation would be created and large lending entities which provide a great deal of borrowing services in Pennsylvania would become affiliates of banks to avoid the regulation. This would also create a competitive imbalance with licensees that would not be able to affiliate themselves with banks. Lastly, since all affiliates of federal and state chartered banks are covered by the regulation, the Department does not believe that state affiliates are at any substantial disadvantage compared with federal affiliates based on the regulation.

*The necessity of the ability to repay provisions of the regulation.*

Many commentators have asserted the ability to repay provisions are not needed because market conditions in the mortgage industry are correcting the deficiencies that the Department is primarily seeking to address, specifically, the practice of lenders and brokers providing mortgage loans to borrowers who did not have the ability to repay the loans they were given. The Department agrees that current mortgage market conditions have seriously restricted mortgage lending in the United States and, specifically, the use of stated income or no documentation loan products. The current market constrictions regarding these loan products are based in large part upon the dangerous lending and brokering practices that evolved over the last ten years, in particular, the practice of ignoring whether borrowers have any reasonable ability to repay the loans they were offered. Indeed, the comments that market conditions are correcting for these unsound practices tacitly acknowledge that there were a great deal of imprudent decisions and improper conduct on the part of lenders, brokers and consumers in the mortgage loan arena. The past several months since the public comment period ended clearly highlight, in the most dramatic fashion, the excess and unsound practices in the mortgage industry that contributed to the current distress in the housing market and the economy as a whole.

The Department does not believe that the response to this crisis, and the harm caused, should be that of inaction. Instead, the Department believes that unless the practices of lending and brokering without regard to an applicant's ability to repay are addressed now, through responsible regulation, such practices will only return when market conditions permit. To ignore what has led up to the current crisis in the mortgage industry and hope that "market corrections" will instill in mortgage professionals a degree of prudence and responsibility in mortgage loan transactions would be unwise. In fact, it is the Department's belief that the regulation's ability to repay provisions will provide a future stabilizing force in the market by providing a degree of assurance to investors and lenders in the secondary market that Pennsylvania licensees gave due consideration to an applicant's ability to repay the offered loan.

*The effect of the regulation on stated income and no documentation loan products.*

Many commentators have asserted that the requirement to verify income and fixed income expenses in the regulation will eliminate loan products such as stated

income and no documentation loans, which are asserted to be useful and appropriate products. These commentators are correct that the verification requirements of the ability to repay provisions of the regulation will prohibit licensees from offering a loan without verifying the income and fixed expenses of applicants. The policy goal of the ability to repay provisions of the regulation is to ensure that licensees conduct a reasonable analysis of the borrower's financial situation in order to determine if the borrower has the ability to repay the offered loan. In drafting the provisions, two factors stood out as having the most direct impact on an applicant's ability to repay: income and fixed expenses. Because of the importance of these two factors, the regulation requires their verification. As a result, a licensee's loan product that currently does not require a licensee to verify income and fixed expenses will be effectively prohibited. Therefore, although there may still be true "no-doc" and "stated income" product loans offered in Pennsylvania by entities not covered by the regulation, licensees will still be required to perform the verification requirements of the regulation which effectively eliminates the purpose of these loans. The Department believes that the convenience of these types of loans, even for those individuals who use the products appropriately, is far outweighed by the larger potential for abuse and the catastrophic harm caused to families who end up in homes they cannot afford and face serious credit risk as well as foreclosure when they are unable to make their loan payments.

On a related note, commentators have also in various comments mentioned "low-documentation" loans, a broad type of loan product that is purported to require minimal documentation. Under the regulation, these loans will also be affected to the extent that such minimal documentation loans do not include verification of income and fixed expenses. It should also be noted that if other information in addition to income and fixed expenses is considered as part of a licensee's analysis, under Section 46.2(g)(4) of the Final-Form Regulation, such other information must be documented by the licensee in the loan file. Therefore, it is possible that the documentation of additional information other than income and fixed expenses may require more documentation than certain lenders currently require for their loan products.

*Stated income and no documentation products and the reasons for foreclosures.*

Commentators also have asserted that the main reasons for foreclosures continue to be traditional reasons such as the loss of a job, medical emergencies and divorce and that stated income or no documentation loans are not a problem or that there is no certainty that stated income or no documentation loan products are responsible for increased foreclosures. The Department recognizes that much has changed in the past several months since the time of the submission of these comments. It is now clear that the proliferation of loan products that were offered without any consideration of the borrowers' ability to repay was, and is, a substantial reason for foreclosures in the United States and the single most cited factor when discussing the collapse of the sub-prime mortgage market, which has had a cascading effect throughout the economy. The practice of providing loans without prudent underwriting was driven by the use of products such as stated income and no documentation loans. Borrowers, lenders, brokers and investors were able to manipulate and abuse stated income and no documentation products to the detriment of the entire country. While in limited circumstances these

products may have been useful for certain borrowers, the Department believes that the potential for abuse outweighs any convenience the products offer. As discussed below, the Department does not believe the verification of the required factors presents a significant hurdle to borrowers or licensees.

*Other factors to consider when performing the ability to repay analysis.*

One commentator has questioned what other factors licensees may consider when performing an ability to repay analysis, other than income and fixed expenses. Section 46.2(g)(4) was drafted to give licensees flexibility in considering factors other than income and fixed expenses when performing an ability to repay analysis. This provision is intended to permit licensees to document information in addition to income and fixed expenses such as: payment history, family gifts, non-collateral assets, seasonal business considerations, business history with lender/broker, new job start date, job relocations, etc. So long as the other considerations are reasonably related to an applicant's ability to repay and documented by the licensee, so that the Department can review the analysis, licensees may consider such additional information.

As a corollary to this comment, many commentators have stated that under the ability to repay provision, certain factors now considered when offering a loan will no longer be able to be utilized, such as payment history, seasonal income and the averaging of income for seasonal or commissioned workers. To the contrary, all such factors may be considered when assessing the applicant's reasonable ability to repay the loan being offered by the licensee. Initially, it should be noted that the new definition of income includes virtually any income that an applicant may receive, whether or not it is seasonal, commissioned, rent payments, etc. The Department believes that in analyzing the income that an applicant receives, a licensee is entirely justified in also considering additional factors such as the seasonal nature of the income, debt payment history, commission history, and if used prudently, census and wage information by profession to anticipate reasonable increases of income over time. However, licensees must be able to articulate the reasoning and basis for the use of such other information to the Department and how it was used when considering the applicant's ability to repay.

***Summary of Major Changes from the Proposed Rulemaking<sup>3</sup>***

*Authority:*

The regulation is being promulgated pursuant to the Department's authority under Section 6138(a)(4) of the Mortgage Act (7 Pa.C.S. § 6138(a)(4)) and Section 12 of the Consumer Discount Company Act (7 P.S. § 6212). The regulation began the promulgation process under the Department's authority under section 310(a) of the Mortgage Bankers and Brokers and Consumer Equity Protection Act (63 P.S. § 456.310(a)) (the "MBBCEPA"), section 16(1) of the Secondary Mortgage Loan Act (7 P.S. § 6616(1)) (the "SMLA") and section 12 of the Consumer Discount Company Act (7

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<sup>3</sup> The Department has revised the proposed regulation and in certain cases, wholly moved sections. Where applicable, the new section cites are indicated. Additionally, in Annex A, where whole sections were moved, any new language is indicated in bold in addition to underscoring.

P.S. § 6212). However, with the passage of the Mortgage Act, the provisions of chapter 3 of the MBBCEPA were combined with the provisions of the SMLA, creating a single consolidated act that regulates the mortgage loan business in Pennsylvania. The Mortgage Act will become effective on November 4, 2008, at which time chapter 3 of the MBBCEPA and the SMLA will be repealed by operation of law.

*Proposed Section 46.1:*

Section 46.1 was revised to include the following definitions: balloon payment, debt obligation, fixed expenses, fully amortized payment schedule, fully indexed rate, hazard insurance, index rate, material change, Mortgage Act, mortgage loan, margin, property taxes, reverse mortgage and variable rate loan. The definitions for first mortgage loan, MBBCEPA, secondary mortgage loan and SMLA were deleted as a result of the passage of the Mortgage Act.

*Proposed Sections 46.2(b) through (d):*

Sections 46.2(b) through (d) set forth the requirements for issuing a one-page disclosure form provided by the Department. These sections were revised and are now sections 46.2(b) through (f) of the final-form regulation. The final-form regulation clarifies who must deliver the disclosure statement, the timing of the issuance of the disclosure by the licensee and the requirements relating to the applicant's signature. The revised scheme also clarifies that a licensee broker, who would be otherwise required to issue the disclosure form, may defer the issuance of the form to a lender, provided that the lender issues the form in accordance with the regulation.

*Proposed Section 46.2(e):*

The proposed regulation's ability to repay analysis requirements were revised and are now sections 46.2(g) through (i) of the final-form regulation. Revisions include the following:

(1) definitions were drafted for balloon payment, debt obligation, fixed expenses, fully amortized payment schedule, fully indexed rate, hazard insurance, index rate, material change, margin, property taxes, reverse mortgage and variable rate loan. *See* Section 46.1.

(2) licensees are only required to verify the income that the applicant is going to rely upon to pay back the loan. *See* Section 46.2(g)(3).

(3) a presumption of ability to repay was included for loans that are insured by the Federal Housing Authority, guaranteed by the United States Department of Veterans Affairs, originated or approved for purchase by the Pennsylvania Housing Finance Agency or subject to a written finding by a United States Department of Housing and Urban Development approved counseling agency that there is a reasonable expectation of ability to repay. *See* Section 46.2(g)(8).

(4) additional guidance relating to an ability to repay analysis with loans that have a balloon payment feature and reverse mortgage loans. *See* Section 46.2(g)(9) and (h).

(5) clarification of the licensee's continuing obligation under the ability to repay provisions. *See* Section 46.2(i).

*Proposed Section 46.2(f):*

The loan transition prohibitions contained in the proposed regulation under section 46.2(f) are now set forth in section 46.2(j) of the final-form regulations. Based upon comments received, the Department removed from the final-form regulation sections 46.2(f)(10) and (12), relating to charging fees for legally required notices and the rendering of legal advice.

*Proposed Section 46.2(g):*

Section 46.2(g) of the proposed regulation addressed loan funding by licensee lenders. Loan funding is now addressed in section 46.2(k) of the final-form regulation. Section 46.2(k) was revised to provide an exception to the funding requirement in cases where the applicant has committed fraud upon the licensee lender. However, any claim of fraud must be raised as an affirmative defense by the licensee in any administrative action brought by the Department and claiming fraud under this subsection does not relieve the licensee of any liability from borrower claims.

*Proposed Section 46.2(h):*

Section 46.2(h) of the proposed regulation is now section 46.2(l) of the final-form regulation. The subsection was revised to require licensee compliance when the applicant requests the documents and if the licensee has the requested documents in its possession.

*Proposed Section 46.2(i):*

Section 46.2(i) of the proposed regulation is now section 46.2(m) in the final-form regulation. This subsection was revised to only cover a licensee lender who holds or services the applicant's loan.

*Proposed Section 46.3:*

The final-form regulation adds an additional provision to section 46.3 relating to the interpretation of the chapter. The provision provides that if a loan is made in good faith in conformity with an interpretation of this chapter by the Department or the courts of this Commonwealth, no penalty for a violation of this chapter shall apply, notwithstanding the relied upon interpretation subsequently may change.

***Entities Affected***

Existing and future licensee brokers and lenders under the Mortgage Act and all licensees under the CDCA will be affected by the final rulemaking.

### ***Costs and Paperwork Requirements***

The final rulemaking will have no fiscal impact on the Department, the Commonwealth and its political subdivisions. The proposed rulemaking will fiscally impact licensees under the Acts to the extent licensees may need to incur costs in order to alter or revise current business practices to comply with the regulation.

### ***Effectiveness / Sunset Date***

Subsections (b) through (i) of the final-form rulemaking will be effective 90 days from publication in the *Pennsylvania Bulletin*. All remaining provisions of the proposed rulemaking will be effective immediately upon publication in the *Pennsylvania Bulletin*.

### ***Regulatory Review***

Pursuant to section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on July 5, 2007, the Department submitted a copy of the proposed rulemaking and a copy of the Regulatory Analysis Form to the Independent Regulatory Review Commission (“IRRC”) and the Chairmen of the House Committee on Commerce and the Senate Committee on Banking and Insurance. A copy of this material is available to the public upon request.

Under section 5(c) of the Regulatory Review Act, IRRC and the Committees were provided with copies of the comments received by the Department during the public comment period. In preparing the final-form rulemaking, the Department has considered all comments from IRRC, the Committees and the public.

Under section 5.1(j.2) of the Regulatory Review Act (71 P.S. § 745.5a(j.2)), on \_\_\_\_\_, the final-form rulemaking was deemed approved by the House and Senate Committees. Under Section 5.1(e) of the Regulatory Review Act (71 P.S. § 745.5a(e)), IRRC met on \_\_\_\_\_ and approved the final-form rulemaking.

### ***Findings***

The Department finds that:

(1) Public notice of proposed rulemaking was given under sections 201 and 202 of the Act of July 31, 1968 (P.L. 769, No. 240)(45 P.S. §§ 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) A public comment period was provided as required by law, and all comments received during the public comment period were considered.

(3) The regulation does not enlarge the purpose of the proposed rulemaking published in the *Pennsylvania Bulletin* on July 31, 2007.

(4) The final-form rulemaking is necessary and appropriate for the administration and enforcement of the Mortgage Act, 7 Pa.C.S. § 6101 *et seq.* (relating to mortgage loan industry licensing and consumer protection) and the Consumer Discount Company Act, 7 P.S. § 6201 *et seq.*

### Order

The Department, acting under 7 Pa.C.S. § 6138(a)(4) and Section 12 of the Consumer Discount Company Act (7 P.S. § 6212) orders that:

- (a) The regulation of the Department, 10 Pa. Code Chapter 46, is adopted.
- (b) The Secretary of Banking shall submit this order and Annex A to the Office of General Counsel and the Office of Attorney General for review and approval as to legality and form, as required by law.
- (c) The Secretary of Banking shall submit this order and Annex A to the IRRC and the Senate and House Committees as required by the Regulatory Review Act.
- (d) The Secretary of Banking shall certify this order and Annex A and deposit them with the Legislative Reference Bureau, as required by law.
- (e) This order shall take effect immediately upon publication in the *Pennsylvania Bulletin*.

BY:

STEVEN KAPLAN  
Secretary of Banking

**Annex A**

**TITLE 10. BANKS AND BANKING**

**PART IV. BUREAU OF CONSUMER CREDIT AGENCIES**

**CHAPTER 46. PROPER CONDUCT OF LENDING AND BROKERING IN THE  
MORTGAGE LOAN BUSINESS**

Sec.

- 46.1. Definitions.
- 46.2. Proper conduct of lending and brokering in the mortgage loan business.
- 46.3. Enforcement.

**Authority**

The provisions of this Chapter 46 are issued under [section 310(a) of the Mortgage Bankers and Brokers and Consumer Equity Protection Act (63 P.S. § 456.310(a)), section 16(1) of the Secondary Mortgage Loan Act (7 P.S. § 6616(1))] 7 Pa.C.S. § 6138(a)(4) and section 12 of the Consumer Discount Company Act (7 P.S. § 6212), unless otherwise noted.

**Source**

The provisions of this Chapter 46 adopted \_\_\_\_\_, effective \_\_\_\_\_, \_\_\_ Pa.B. \_\_\_\_, unless otherwise noted.

**§ 46.1. Definitions.**

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

*Advertising* – As defined in 12 CFR 226.2(a)(2) (relating to definitions and rules of construction).

*Applicant* – A person who submits an application for a loan.

*Application* – As defined in [12]24 CFR 3500.2(b) (relating to definitions).

*Balloon payment* – A scheduled loan payment that is more than twice as large as the average of earlier scheduled monthly payments.

*CDCA* – The Consumer Discount Company Act (7 P. S. §§ 6201-6219).

*Consummation* – As defined in 12 CFR 226.2(a)(13) (relating to definitions and rules of construction).

Covered loan – A covered loan as defined in section 503 of the [MBBCEPA] Mortgage Bankers and Consumer Equity Protection Act (63 P.S. § 456.503).

Debt obligation – Any amount owed for funds borrowed including interest requirements.

Fixed expenses – Any debt obligations, revolving charge accounts, alimony payments, child support payments, payments pursuant to a separate maintenance agreement, housing association fees and property taxes and hazard insurance on the property to be mortgaged, whether or not such property taxes and hazard insurance are required to be escrowed.

[First mortgage loan – A mortgage loan as defined in section 302 of the MBBCEPA (63 P.S. § 456.302)]

Fully amortized payment schedule – An amortizing payment schedule based on the term of the loan.

Fully indexed rate – The index rate plus the margin for the offered loan.

Hazard insurance – Insurance that covers property damage caused by fire, wind, storms, and other similar risks.

Income – Gross income [A] as defined in 26 U.S.C. § 61 (relating to definitions).

Index rate – A published interest rate to which the interest rate on a variable rate loan is tied.

Licensee – A licensee broker or lender under the [MBBCEPA, SMLA,] Mortgage Act or CDCA or a partially exempt entity under the [MBBCEPA] Mortgage Act.

Loan –

- (i) A [first] mortgage loan [or secondary mortgage loan] or loan involving a mortgage by a licensee under the CDCA, or both, as the context may require.
- (ii) The term does not include a covered loan.

Material change – A change of fact or circumstance that the licensee knows or reasonably should know would substantially affect an applicant's ability to repay the offered loan, including an increase in the interest rate which would require a disclosure under 12 CFR 226.17(f)(2) (relating to general disclosure requirements).

Margin – The number of percentage points a lender adds to the index rate to calculate the interest rate at each adjustment period on variable rate loans.

[MBBCEPA – The Mortgage Bankers and Brokers and Consumer Equity Protection Act (63 P. S. §§ 456.101 - 456.3101).]

Mortgage Act – 7 Pa.C.S. §§ 6101 – 6153.

Mortgage loan – As defined in 7 Pa.C.S. § 6102 (relating to definitions).

*Mortgage loan business* – The [first] mortgage loan business as defined in [section 302 of the MBBCEPA, the secondary mortgage loan business as defined in section 3(a)(5) of the SMLA (7 P.S. § 6603(a)(5)),] 7 Pa.C.S. § 6102 (relating to definitions) and any kind of mortgage lending or brokering activity conducted by a licensee under the CDCA.

*Person* – A person as defined in [section 302 of the MBBCEPA, section 2 of the SMLA (7 P.S. § 6602)] 7 Pa.C.S. § 6102 (relating to definitions) and section 2 of the CDCA (7 P.S. § 6202), as applicable.

*Property taxes* – The taxes assessed, or a reasonable estimate of the taxes to be assessed, on the property being mortgaged based upon the full value of the property and any improvements thereon.

*Reverse mortgage* – A loan that is a reverse mortgage transaction as defined in 12 CFR 226.33(a) (relating to requirements for reverse mortgages).

[SMLA – The Secondary Mortgage Loan Act (7 P.S. §§ 6601-6627).]

[*Secondary mortgage loan* – A secondary mortgage loan as defined in section 2 of the SMLA 7 P.S. § 6602.]

*Variable rate loan* – A loan where the interest rate varies over the term of the loan.

## **§ 46.2. Proper conduct of lending and brokering in the mortgage loan business.**

(a) *Advertising.* A licensee may not engage in false or misleading advertising.

(b) *Disclosures to applicant.* On a form prescribed by the Department [and signed and dated by the applicant and the licensee], a licensee who [has contact with the applicant] takes an application shall disclose the following to the applicant [no later than 3 business days after the application is received or prepared by the licensee]:

- (1) If the lender providing the loan will escrow the applicable property taxes and hazard insurance.
- (2) If the licensee is a lender with the ability to directly lock-in a loan interest rate.
- (3) Whether the loan contains a variable interest rate or balloon payment feature.
- (4) Whether the loan includes a prepayment penalty.
- (5) Whether the loan has a negative amortization feature.

(c) [*Required redisclosures.* A licensee who has issued the disclosure form required by subsection (b) shall issue an updated disclosure form at the time the licensee knows or reasonably should know that the initial disclosure form is inaccurate.] *Timing and issuance of disclosure form.* A licensee issuing the disclosure form required by subsection (b) shall sign and date the disclosure form and deliver or place in the mail the disclosure form within 3 business days after the application is received or prepared by the licensee.

(d) [*Required retention of disclosure form.* A licensee shall retain the disclosure form required by subsections (b) and (c) in the applicant's loan file.] *Required redisclosures.* A licensee who has issued the disclosure form required by subsection (b) shall issue an updated disclosure form at the time the licensee knows or reasonably should know that the initial disclosure form is inaccurate.

(e) [*Evaluation of applicant ability to repay.*

(1) A licensee shall not offer a loan without having reasonably determined, based on the documents and information provided under this subsection, that the applicant will have the ability to repay the loan in accordance with the loan terms and conditions by final maturity at the fully indexed rate, assuming a fully amortized repayment schedule.

(2) In performing an analysis to determine whether an applicant will have the ability to repay a loan, a licensee shall consider, verify and document the following:

- (i) income of the applicant.
- (ii) fixed expenses of the applicant.

(3) A licensee may consider and document information in addition to verified income and fixed expenses as required in subsection (e)(2) in determining an applicant's ability to repay an offered loan, provided that the additional factors are reasonably related to an applicant's ability to repay.

(4) A licensee shall not primarily rely upon the sale or refinancing of an applicant's collateral in determining an applicant's ability to repay an offered loan.

(5) All records, worksheets, and supporting documentation used in the licensee's ability to repay analysis shall be maintained in the applicant's loan file.

(6) In determining an applicant's ability to repay a loan offered under this subsection, a licensee shall not ignore facts or circumstances that it knows or reasonably should know which would indicate that an applicant does not have the ability to repay the offered loan.

(7) In addition to the analysis required by this subsection, great weight and due consideration shall be given to the Guidance on Nontraditional Mortgage Product Risks, as amended, issued by the Department in establishing a licensee's internal procedures and

guidelines when implementing the ability to repay analysis required by this subsection.] Applicant acknowledgment and retention of disclosure form. A licensee shall require an applicant to sign and date the disclosure form required by subsections (b) and (d) within 10 business days after delivery or mailing and shall retain the original executed disclosure form in the applicant's loan file.

(f) [*Loan transaction prohibitions.* A licensee may not:

(1) Advise or imply to an applicant that the applicant's income is not relevant to the loan transaction.

(2) Recommend or imply that an applicant default on any existing contract or financial obligation.

(3) Advise or induce an applicant to refinance an existing loan or otherwise enter into a new financial obligation without performing the ability to repay analysis required by subsection (e).

(4) If an applicant qualifies for a loan offered by the licensee, offer to the applicant a covered loan without advising the applicant that the applicant qualifies for a loan other than a covered loan.

(5) Advise or imply that an applicant should ignore any required disclosures or suggest that a document or the execution of any document is unimportant or of no consequence.

(6) Direct, encourage, permit or otherwise be involved with the improper execution of any document, including:

(i) Requesting or allowing an applicant to sign documents that contain blank spaces where material information regarding the loan transaction is required.

(ii) Permitting the execution of documents where signatures are required to be witnessed without the witnesses being physically present.

(iii) Permitting someone other than the required signatory to execute a document unless otherwise authorized by law.

(7) Knowingly submit or permit or encourage an applicant or third party to submit, false or misleading information, or information that the licensee reasonably should know is false or misleading, to any party to a loan transaction.

(8) Improperly influence, or attempt to improperly influence:

- (i) An appraiser by committing any act or omission that is intended to:
  - (A) Compromise the independent judgment of an appraiser.
  - (B) Ensure that an appraisal matches a requested or target value.
- (ii) Any other entity related to the mortgage loan business, such as notaries, title companies, real estate agents, builders and sellers of properties.

(9) Obtain insurance required for a loan for an applicant at loan consummation without providing the applicant with the opportunity to secure or provide evidence of their own insurance.

(10) Charge an applicant a fee for any legally required notices or disclosures unless otherwise authorized by law.

(11) Pay compensation to or receive compensation from, contract with, or employ any person engaged in the mortgage loan business who is not licensed or otherwise exempt from licensure.

(12) Render legal advice to an applicant.] Duplication. A licensee broker taking an application is not required to provide the disclosure form required by subsections (b) and (d) if the lender making the loan elects to provide the required disclosure form in accordance with the provisions of this section.

(g) [*Loan funding.*

(1) A licensee lender may not refuse or fail to fund a consummated loan, other than when an applicant rescinds the loan in accordance with 12 CFR 226.15 or 226.23 (relating to the right of rescission), as applicable.

(2) A licensee lender shall fund a consummated loan in a reasonable time period after consummation of the loan or in accordance with any commitment or agreement with the applicant; provided that, if an applicant has a right of rescission under 12 CFR 226.15 or 226.23 (relating to the right of rescission), a licensee lender is not required to fund a consummated loan in accordance with this subsection until after the applicable rescission period has ended.

(3) Any post-closing underwriting or quality control review conducted by a licensee lender after the consummation of a loan shall not delay the funding of a loan or result in a failure or refusal to fund the loan in accordance with the provisions of this subsection.

(4) A licensee shall disburse loan funds in accordance with any commitment or agreement with the applicant.] Evaluation of applicant ability to repay.

(1) A licensee may not offer a loan without having reasonably determined, based on the documents and information provided under this subsection, that the applicant will

have the ability to repay the loan in accordance with the loan terms and conditions by final maturity at the fully indexed rate, assuming a fully amortized repayment schedule.

(2) In performing an analysis to determine whether an applicant will have the ability to repay an offered loan, a licensee shall consider, verify and document the [following]:

- (i) Income of the applicant.
- (ii) Fixed expenses of the applicant.

(3) When performing the income verification required by paragraph (2), a licensee is only required to verify the income that the applicant chooses to rely upon to repay the offered loan.

(4) **In performing an evaluation of an applicant's ability to repay,** a licensee may consider and document **supplemental information provided by the applicant** in addition to [verified] income [and fixed expenses as required in subsection (2) in determining an applicant's] **that demonstrates that the applicant has the ability to repay [an] the offered loan,** provided that the [additional factors are] **supplemental information is** reasonably related to an applicant's ability to repay.

(5) A licensee may not primarily rely upon the sale or refinancing of an applicant's collateral in determining an applicant's ability to repay an offered loan.

(6) [The] **All** records, worksheets, and supporting documentation used in the licensee's ability to repay analysis shall be maintained in the applicant's loan file.

(7) In determining an applicant's ability to repay [a loan offered] **an offered loan** under this subsection, a licensee may not ignore facts or circumstances that it knows or reasonably should know which would indicate that an applicant does not have the ability to repay the offered loan.

(8) An applicant may be presumed to have the ability to repay an offered loan if the offered loan has one of the following characteristics:

- (i) Is insured by the Federal Housing Administration.
- (ii) Is guaranteed by the United States Department of Veterans Affairs.
- (iii) Is originated or approved for purchase by the Pennsylvania Housing Finance Agency.
- (iv) Is the subject of a written finding by a United States Department of Housing and Urban Development approved counseling agency that there is a reasonable expectation that the borrower will be able to repay the offered loan.

(9) For an offered loan with a balloon payment, a licensee:

- (i) May consider the sale or refinance of the applicant's collateral when evaluating an applicant's ability to make the balloon payment.
- (ii) Shall base the fully amortized payment schedule on the full term the borrower chooses when calculating the amortization period for a loan containing a borrower option for an extended amortization period.
- (iii) Shall consider the due date of the balloon payment and if there is a reasonable expectation the applicant will have sufficient equity in the property to make the balloon payment through a sale or refinance of the residence.

(h) *[Licensee responsibility to provide documents.* A licensee shall provide to an applicant or authorized representative of an applicant, unless prohibited by federal or state law, copies or originals of the documents associated with a loan that an applicant has paid for or signed, such as loan applications, appraisals, surveys, loan documents, disclosures and any fee agreement executed by the applicant and the licensee.] *Reverse mortgages.* A licensee offering or making a reverse mortgage to an applicant is not required to comply with subsections (b), (g), (i) and (j)(3).

(i) *[Payoff statement or statement of mortgage reinstatement.* A licensee lender shall provide a borrower with payoff statements or statements of mortgage reinstatement, as applicable, for the borrower's loan within 7 business days of receipt of a written request by a borrower or a person authorized by the borrower.] *Material changes and ability to repay.* If there is a material change after a licensee has performed the ability to repay calculation required by subsection (g), a licensee shall immediately:

(1) If the licensee is a broker, send a notice to the applicant disclosing the material change and that the material change may affect the applicant's ability to repay the offered loan.

(2) If the licensee is a lender, perform another ability to repay analysis in accordance with subsection (g).

(j) *Loan transaction prohibitions.* A licensee may not:

(1) Advise or imply to an applicant that the applicant's income is not relevant to the loan transaction.

(2) Recommend or imply that an applicant default on any existing contract or financial obligation.

(3) Advise or induce an applicant to refinance an existing loan or otherwise enter into a new financial obligation without performing the ability to repay analysis required by subsection [(e)] (g).

(4) If an applicant qualifies for a loan offered by the licensee, offer to the applicant a covered loan without advising the applicant that the applicant qualifies for a loan other than a covered loan.

(5) Advise or imply that an applicant should ignore any required disclosures or suggest that a document or the execution of any document is unimportant or of no consequence.

(6) Direct, encourage, permit or otherwise be involved with the improper execution of any document, including:

(i) Requesting or allowing an applicant to sign documents that contain blank spaces where material information regarding the loan transaction is required.

(ii) Permitting the execution of documents where signatures are required to be witnessed without the witnesses being physically present.

(iii) Permitting someone other than the required signatory to execute a document unless otherwise authorized by law.

(7) Knowingly submit or permit or encourage an applicant or third party to submit, false or misleading information, or information that the licensee reasonably should know is false or misleading, to any party to a loan transaction.

(8) Improperly influence, or attempt to improperly influence:

(i) An appraiser by committing any act or omission that is intended to:

(A) Compromise the independent judgment of an appraiser.

(B) Ensure that an appraisal matches a requested or target value.

(ii) Any other entity related to the mortgage loan business, such as notaries, title companies, real estate agents, builders and sellers of properties.

(9) Obtain **hazard** insurance required for a loan for an applicant at loan consummation without providing the applicant with the opportunity to secure or provide evidence of the applicant's own **hazard** insurance.

(10) Pay compensation to or receive compensation from, contract with, or employ any person engaged in the mortgage loan business who is not licensed or otherwise exempt from licensure.

(k) Loan funding.

(1) A licensee lender may not refuse or fail to fund a consummated loan, other than when an applicant rescinds the loan in accordance with 12 CFR 226.15 or 226.23 (relating to the right of rescission), as applicable **except as provided in paragraph (4).**

(2) A licensee lender shall fund a consummated loan in a reasonable time period after consummation of the loan or in accordance with any commitment or agreement with the applicant; provided that, if an applicant has a right of rescission under 12 CFR 226.15 or 226.23 (relating to the right of rescission), a licensee lender is not required to fund a consummated loan in accordance with this subsection until after the applicable rescission period has ended.

(3) A licensee shall disburse loan funds to third parties in accordance with any commitment or agreement with the applicant.

(4) Any post-closing underwriting or quality control review conducted by a licensee lender after the consummation of a loan may not delay the funding of a loan or result in a failure or refusal to fund the loan in accordance with this subsection **unless the applicant has committed fraud against the licensee, which may be raised as an affirmative defense in any proceeding brought by the Department based upon a violation of this subsection.**

(5) Nothing in this subsection shall relieve or limit the liability of a licensee against a claim of a borrower based upon a licensee's refusal or failure to fund a loan based upon an allegation of consumer fraud.

(l) Licensee responsibility to provide documents. Upon request, [A] a licensee shall provide to an applicant or authorized representative of an applicant, unless prohibited by federal or state law, copies or originals of the documents associated with a loan that an applicant has paid for or signed, such as loan applications, appraisals, surveys, loan documents, disclosures and any fee agreement executed by the applicant and the licensee, **to the extent such documents are in the licensee's possession.**

(m) Payoff statement or statement of mortgage reinstatement. A licensee lender **that holds or services a loan** shall provide a borrower with payoff statements or statements of mortgage reinstatement, as applicable, for the borrower's loan within 7 business days of receipt of a written request by a borrower or a person authorized by the borrower.

**§ 46.3. Enforcement.**

(a) Violations. Violations of the provisions of this chapter shall be violations of the [MBBCEPA, SMLA] Mortgage Act and CDCA, as applicable.

(b) Interpretation of chapter. If a loan is made in good faith in conformity with an interpretation of this chapter (Chapter 46) by the Department or the courts of this Commonwealth, no penalty for a violation of this chapter shall apply, notwithstanding that after such loan is consummated, such interpretation, rule or regulation is amended, rescinded or determined by a judicial or other authority to be invalid for any reason.

**PENNSYLVANIA DEPARTMENT OF BANKING COMMENT AND RESPONSE DOCUMENT FOR THE  
PROPOSED REGULATION REGARDING THE PROPER CONDUCT OF LENDING AND BROKERING IN  
THE MORTGAGE LOAN BUSINESS (REGULATION 3-43)**

The Commonwealth of Pennsylvania, Department of Banking (the "Department"), is seeking to promulgate a regulation regarding the proper conduct of lending and brokering in the mortgage loan business under 7 Pa.C.S. § 6101 *et seq.* (relating to mortgage loan industry licensing and consumer protection) (the "Mortgage Act") and the Consumer Discount Company Act, 7 P.S. § 6201 *et seq.* (the "CDCA") (jointly referenced hereafter as the "Acts").<sup>1</sup>

The Department of Banking has been deeply involved in a comprehensive review of the practice of mortgage lending and brokering in the Commonwealth of Pennsylvania. Over the past three years the Department has studied and documented the Commonwealth's mortgage landscape, issued a statement of policy with regard to unethical lending practices, worked with the industry and consumer advocacy groups regarding this regulation, and collaborated with the Legislature to draft six legislative proposals. For more information about the substance and status of this ongoing work, please visit [www.banking.state.pa.us](http://www.banking.state.pa.us).

The Department is promulgating this regulation because, in the past decade, the mortgage loan business has significantly increased in complexity and competitiveness, resulting in a drastically changed borrowing landscape. Prior to the Department commencing the formal promulgation process in July of 2007, the proposed regulation was extensively vetted over two years with industry representatives and consumer organizations. The pre-promulgation vetting culminated in a public hearing and request for written comment that was noticed in the *Pennsylvania Bulletin* as an Advanced Notice of Proposed Rulemaking on July 29, 2006. After the public hearing in September of 2006, the Department continued to review the regulation with input from interested parties up until the time the regulation was submitted and published as a proposed regulation in the *Pennsylvania Bulletin* on July 31, 2007. After receipt and review of the comments received during the public comment period, the Department continued its dialogue with industry and consumer representatives, which included an additional limited vetting of the Department's revisions to the regulation based upon the comments received.

The following are the Department's responses to the comments received during the public comment period. Each commentator has been assigned a number that will reflect the identity of the commentator in parentheses after the comment.

**Commentators**

|                                |   |
|--------------------------------|---|
| Fairway Consumer Discount Co.  | 1 |
| Moreland Financial Corporation | 2 |

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<sup>1</sup> The regulation began the promulgation process under the Department's authority under section 310(a) of the Mortgage Bankers and Brokers and Consumer Equity Protection Act (63 P.S. § 456.310(a)) (the "MBBCEPA"), section 16(1) of the Secondary Mortgage Loan Act (7 P.S. § 6616(1)) (the "SMLA") and section 12 of the Consumer Discount Company Act (7 P.S. § 6212); however, on July 8, 2008, the Governor signed into law the Mortgage Act, which combined chapter 3 of the MBBCEPA with the SMLA to create a single consolidated act that regulates the mortgage loan business in Pennsylvania. The Mortgage Act will become effective on November 4, 2008, at which time chapter 3 of the MBBCEPA and the SMLA will be repealed by operation of law.

|   |    |
|---|----|
| Provident Mortgage Corporation                        | 3  |
| American Federal Mortgage Corporation                 | 4  |
| Jared Alexander                                       | 5  |
| Form Comment  | 6  |
| Housing Alliance Project                              | 7  |
| WF&K Mortgage, Inc., 8-17-08, Karbowski, Art          | 8  |
| WF&K Mortgage, Inc., 8-15-08, Karbowski, Art          | 9  |
| Wayne J. Angelo                                       | 10 |
| Thomas Gallagher                                      | 11 |
| Pennsylvania Association of Community Bankers         | 12 |
| TriState Capital                                      | 13 |
| White Star Lending Group, Inc.                        | 14 |
| National Reverse Mortgage Lending Association         | 15 |
| Financial Freedom                                     | 16 |
| AFC Reverse Mortgage                                  | 17 |
| Bank of America                                       | 18 |
| Eric Fishman  | 19 |
| WF&K Mortgage, Inc., Rick Andrews                     | 20 |
| John Mattaboni  | 21 |
| Tim Turner  | 22 |
| Christine Miller-Brown                                | 23 |
| American Advantage Mortgage Services                  | 24 |
| Pennsylvania Association Mortgage Brokers             | 25 |
| Carl Mollica  | 26 |
| Sheritha D. McKenzie                                  | 27 |
| Carteret Mortgage Corporation                         | 28 |
| Barbara Broadbent                                     | 29 |
| AFG Financial Group                                   | 30 |
| Pennsylvania Bankers Association                      | 31 |
| HomeVestors   | 32 |
| AMC Mortgage Corporation                              | 33 |
| Jennifer Schmalhger                                   | 34 |
| Equity Lending Group, Inc.                            | 35 |
| Synergy Financial Group                               | 36 |
| Mortgage Bankers Association                          | 37 |
| Al Romero   | 38 |
| Pennsylvania Financial Services Association           | 39 |
| Philadelphia Unemployment Project                     | 40 |
| Community Action Committee of Lehigh Valley           | 41 |
| Association of Community Organizations for Reform Now | 42 |
| Community Legal Services                              | 43 |
| WF&K, Mortgage, Inc., Ralph Hahn                      | 44 |
| Liberty Home Mortgage Company                         | 45 |
| Robert Dunn   | 46 |
| Loan Express, Inc., Heidi Oley                        | 47 |

|  |    |
|--|----|
| Loan Express, Inc., Pete Z. Ackourey     | 48 |
| John Young                               | 49 |
| Independent Regulatory Review Commission | 50 |

### General Comments Regarding the Regulation

1. **Comment.** Several commentators have requested that the Department clarify its position on the coverage of the regulation relating to subsidiaries and affiliates of federal and state-chartered banking institutions. These commentators have also requested that the Department exempt such entities from the regulation. (12, 31, 50)

**Response.** Subsidiaries of federal and state-chartered banks are statutorily exempted from coverage under the Mortgage Act and, accordingly, from the regulation also. Under the CDCA, although the plain language does not exempt subsidiaries of federal and state-chartered banks, the Department recognizes federal preemption as a result of cases such as Watters v. Wachovia Bank, N.A., U.S., 127 S.Ct. 1559, 167 L.Ed.2d 389, 75 USLW 4167 (2007). Therefore, the Department will not enforce or administer the CDCA against entities that set forth a valid claim of federal preemption. The Department also will not enforce or administer the CDCA against subsidiaries of state-chartered banks that have availed themselves of similar treatment through the parity provisions of the Banking Code of 1965, 7 P.S. § 201(c).

As to affiliates of federal and state-chartered banks, the Mortgage Act and the CDCA do not provide exemptions for such entities and the Department is not aware of any assertion or ruling of preemption regarding these entities. Therefore, the regulation will apply to such affiliates. The Department believes that the exclusion of such entities would seriously hinder the Department's efforts to address improper lending practices in Pennsylvania by creating a significant regulatory vacuum, which would lead to risk and exposure to Pennsylvania borrowers. The Department is also concerned that by exempting affiliates, a relatively easy method for evasion of the regulation would be created and large lending entities which provide a great deal of borrowing services in Pennsylvania would become affiliates of banks to avoid the regulation. This would also create a competitive imbalance with licensees that would not be able to affiliate themselves with banks. Lastly, since all affiliates of federal and state chartered banks are covered by the regulation, the Department does not believe that state affiliates are at any substantial disadvantage compared with federal affiliates based on the regulation.

2. **Comment.** Several commentators have asserted that the Department's efforts should be concentrated on eliminating the "bad actors" from the industry through examinations, enforcement and the licensing of loan originators. (10, 24, 29, 35)

**Response.** The Department agrees that additional licensing and enforcement authority over loan originators will do a great deal to assist the Department in holding individuals as well as companies accountable for violations of the Acts. In furtherance of this goal, legislation was recently enacted which, among other requirements, mandates the individual licensing of loan originators. However, the Department believes that such licensing will not be completely effective without addressing improper conduct in the mortgage loan business.

3. **Comment.** Another commentator has questioned the necessity for many of the provisions of the regulation because most of the conduct addressed by the regulation is already illegal, presumably under other state and federal laws. (12)

**Response.** To the extent that the regulation already addresses certain conduct that may be considered illegal or prohibited under other state or federal laws, the Department believes that it should have the authority to directly address such practices under its regulatory authority. As the primary regulator of licensees under the Acts within the Commonwealth, the Department must have the ability to proscribe and, if necessary, prosecute improper conduct under its own authority.

4. **Comment.** One commentator has asserted that the regulation is generally too subjective and does not provide sufficient guidance to the industry of the conduct that is being proscribed. The commentator further asserts that the Department inappropriately seeks to insert its own judgment into the loan transaction process. (12)

**Response.** As will be noted in further detail below, the Department has taken steps to place objective standards within the regulation where appropriate; however, as is the case with any business or profession where discretionary judgment is required, "bright-line" standards are sometimes not effective or are too restrictive. The Department seeks to provide licensees with guidance and, more importantly, flexibility to operate. While a regulation with hard and fast objective criteria would provide simple rules for the industry, the industry would lose flexibility in conducting its business, and would argue that the regulation is too strict. The Department believes that the regulation as revised is sufficiently clear as to the conduct that the Department considers improper and that licensees will be able to adjust accordingly. However, as with any new regulation, the Department understands that there will be an initial time of adjustment for some licensees and the Department expects and welcomes inquiries from those licensees or trade associations regarding the regulation and its application. Lastly, the Department is not seeking to replace a licensee's judgment with its own. Rather, the Department is seeking through the regulation to ensure that licensees carefully exercise their professional judgment because the transactions that licensees conduct involve the most significant financial decision many consumers will make, the purchase or financing of their home.

5. **Comment.** One commentator has suggested that the Department impose a duty of good faith and fair dealing in the regulation to address future predatory concerns. (42)

**Response.** The Department believes that the regulation as proposed will assist in the prevention of predatory practices, the most significant of which the Department believes is placing applicants in loans when there was never any reasonable chance that the applicant could afford the loan. The Department recognizes that in the future there will be new abusive and improper practices unforeseen today. However, the Department questions the proposition that imposing a duty of good faith and fair dealing would significantly deter and/or enable the Department to prevent these unknown future practices.

The Department does note that it already has significant authority under the Mortgage Act to suspend, revoke or refuse to renew licenses for: (1) dishonest, fraudulent, illegal practices

or conduct in any business; (2) unfair or unethical conduct or practices in the mortgage business; and (3) incompetence or negligence. See 7 Pa.C.S. § 6139(a). The Department believes that this language provides a valuable tool to address future conduct not foreseen at this time. The Department also may promulgate further regulations defining what is proper in the future should the need arise.

6. **Comment.** Several commentators have requested that the Department impose a fiduciary duty between applicants and mortgage brokers through the regulation. (41, 43)

**Response.** The Department believes that establishing a fiduciary duty between mortgage brokers and consumers would require statutory amendments to the Acts. Notwithstanding the forgoing, the Department believes that its position should not be construed to conflict with any precedent established through common law by the courts of this Commonwealth regarding a fiduciary duty between mortgage brokers and consumers.

7. **Comment.** Several commentators have also suggested that the Department impose a suitability standard for loans offered by licensees. (40, 41, 42, 43)

**Response.** The Department believes that requiring an ability to repay analysis is the appropriate balance to strike in addressing the deficiencies in the mortgage market. Requiring further analysis and obligations that would accompany a suitability standard at this time would be overly complex and restrictive. The Department will carefully monitor the effects of the regulation using the ability to repay analysis going forward to determine whether further regulation is needed in this area.

8. **Comment.** Several commentators have requested that the Department mandate that licensee lenders escrow property taxes and hazard insurance for all borrowers who receive sub-prime loans. (41, 42, 43)

**Response.** The Department believes that mandating the escrowing of property tax and insurance payments of borrowers who receive sub-prime loans would require statutory amendments to the Acts. The Department also notes that there is no universal definition of a sub-prime loan and the Acts do not provide for such a definition, making implementation of a sub-prime escrow rule difficult. Lastly, the Department believes that requiring the mandatory escrowing of property taxes and hazard insurance would limit the choice for applicants.

9. **Comment.** One commentator has expressed concern that the regulation will change the documentation requirements of government-sponsored entities and investors in the secondary market (jointly referred to hereafter as "Secondary Market Purchasers"). (31)

**Response.** The regulation does not impose documentation requirements upon entities other than those entities that are covered by the regulation. Furthermore, because the regulation does not impose assignee liability, Secondary Market Purchasers should not be affected by the regulation. As a result, whatever the documentation requirements currently imposed or will be imposed in the future by Secondary Market Purchasers will be unchanged by the regulation. What the regulation may require is that licensees collect and retain in their own licensee loan

files additional documentation that may not be required by Secondary Market Purchasers. If anything, the Department believes that the additional documentation licensees are required to collect and maintain will make Pennsylvania loans more stable and more attractive to Secondary Market Purchasers because these loans will have been carefully analyzed for ability to repay, making the loans less likely to default for non-traditional reasons.

**10. Comment.** Another commentator has expressed concern regarding the overall effect of the regulation on the sale of Pennsylvania loans on the secondary market, in particular, the need to purchase mortgages on the secondary market without undue complication or excessive legal risk. (37)

**Response.** The Department further notes that the Acts and, accordingly, the regulation, do not impose any type of assignee liability upon holders in due course and, therefore, there should be no assignee liability concerns for secondary market purchasers and investors. Any requirements within the regulation regarding additional documentation or analysis regarding offered loans must be completed and satisfied at or before loan closing and before the sale of the loan on the secondary market. Investors or purchasers on the secondary market will be no more exposed to uncertainty or legal risk than they are today. As referenced above in the Department's response to Comment 9, the Department believes that the regulation will provide a benefit to sales on the secondary market rather than uncertainty or legal risk. Notwithstanding the forgoing, the regulation does not prohibit parties from entering into contractual agreements that may or may not address liability concerns among private parties for not complying with the regulation, for example, in re-purchase agreements.

**11. Comment.** Two commentators have requested that the Department require written fee agreements between mortgage brokers and applicants. (7, 43)

**Response.** The Department believes that it is a good practice to have written fee agreements in place between brokers and applicants that fully disclose any charges or fees associated with the mortgage broker's employment. Currently federal law requires the disclosure of fees and charges regarding the loan transaction. Although the current disclosure scheme has acknowledged shortcomings, new federal disclosure rules have been proposed that the Department believes will make loan fees and charges more transparent, allowing applicants to better assess costs and comparison shop. The Department will continue to review issues surrounding broker fees and costs associated with loan transactions and the issue of whether or not written fee agreements should be required between mortgage brokers and borrowers.

**12. Comment.** Several commentators have alleged that the proposed "legislation" contains fee restrictions. (8, 9, 20, 44)

**Response.** The Department has never placed any fee restrictions or caps in the regulation.

**13. Comment.** One commentator has asserted that the Department's regulation is seeking to prevent or regulate consumers from exercising bad judgment. (10)

**Response.** The Department agrees and acknowledges that some consumers may display poor judgment when entering into loan transactions. However, certain licensees have also displayed poor judgment in offering loans to people who did not have any reasonable ability to pay the loans back. The regulation is intended to address the conduct of licensees and certain conduct that has enabled consumers to exercise poor judgment, which benefits both the consumer and the industry as a whole.

**14. Comment.** One commentator has alleged that the Department lacks the statutory authority to promulgate the regulation and that the regulation is not consistent with the legislative intent of the Acts. (33)

**Response.** The Department has been granted authority by the General Assembly to regulate the conduct of its licensees under the Acts, as evidenced by the plain language of each of the Acts. In particular, each of the Acts allows the Department to issue regulations to ensure the proper conduct of licensees in their respective loan businesses. See 7 Pa.C.S. § 6138(a)(4) and 7 P.S. § 6212.

**15. Comment.** One commentator has asserted that the regulation excludes loans covered by the MBBCEPA. (7)

**Response.** The regulation only excludes “covered loans” which are defined in section 503 of the MBBCEPA, 63 P.S. § 456.503. All other loans regulated by the Mortgage Act and residential mortgage loans under the CDCA are covered by the regulation.

**16. Comment.** Two commentators have requested that the Department add a provision to the regulation to prohibit the steering of applicants into certain loan products with higher fees and interest rates when the applicants qualify for loans with lower fees and interest rates also offered by licensees. (41, 42)

**Response.** The Department acknowledges that steering consumers to more expensive loans when they also qualify for less expensive loans offered by the licensee may occur. The Department believes that it currently has authority to address this conduct and will closely scrutinize any allegations that licensees are giving loans to borrowers with high interest rates and/or fees solely for the purpose of obtaining a higher commission or profit when the applicant also qualifies for a less expensive loan offered by the licensee. See e.g. 10 Pa. Code § 48.3(4). The Department will consider additional regulation in the future if it is determined that further regulation is needed to address inappropriate steering.

**17. Comment.** Concern was expressed that, under the regulation, lenders are not required to fully explain the effects of a variable rate loan over time and the Department’s proposed disclosure form is not enough. (40)

**Response.** The Department believes that the proposed disclosure requirements in the regulation combined with the existing federal disclosures provide sufficient information to the borrowers regarding the effects of variable rate loans and should prompt consumers to ask additional questions regarding their loans. The Department also notes that federal disclosures are

currently being proposed that will provide additional information to borrowers allowing them to understand loan features and costs. The Department will continue to monitor the enactment of the revised federal disclosure requirements to determine if additional state requirements are necessary.

### Specific Comments to Provisions of the Regulation

#### Section 46.1 [Final-Form § 46.1]

18. **Comment.** One commentator has indicated that the federal citation contained in the definition of application is incorrect. (12)

**Response.** The Department has corrected the citation. The citation now reads “24 CFR 3500.2(b) (relating to definitions).”

#### General Comments on Section 46.2(b) through (d) [Final-Form § 46.2 (b) – (f)]

19. **Comment.** Several commentators have asserted that the disclosures required by the regulation are already addressed by federal disclosure laws and are duplicative. (3, 12, 31)

**Response.** The Department believes that the required one page simplified disclosure form informing applicants of important loan conditions that directly relate to their monthly payments will assist applicants in understanding the important loan features and will more effectively highlight these important loan terms than the current federal disclosure forms.

20. **Comment.** One commentator has stated that the disclosure requirements of the regulation will be operationally expensive and difficult to install. (31)

**Response.** The Department acknowledges that there will be some cost associated with the implementation of the disclosure form. However, the Department does not believe that implementation of issuing a single page disclosure in addition to existing disclosures will be overly burdensome. It is anticipated that vendors in the mortgage industry will quickly move to automate the issuance of the required disclosure form so licensees will have an automated option. The disclosure form will also be readily available on the Department’s website for downloading and the anticipated labor requirements for filling out the form, which will be in a “check-the-box” format, does not appear to the Department to be so insurmountable as to make manual completion unduly burdensome or impossible. Lastly, the Department notes that Pennsylvania is not the only state to require disclosures in addition to those required by federal law. States such as Ohio, Washington and North Carolina, to name a few, all have additional disclosures regarding various aspects of the loan transaction.

21. **Comment.** Several commentators have requested that the Department reinsert language contained in an earlier draft of the regulation that required oral explanations by licensees of the loan terms and conditions. (7, 40, 42, 43)

**Response.** The requirement for oral explanations was removed by the Department after comments were received from industry and consumer representatives after the Department's Advanced Notice of Proposed Rulemaking. It was expressed to the Department that such a requirement, while laudable, would only create situations of conflicting accounts of what was orally explained and would provide a complete defense to licensees who would claim they explained everything to the applicants. After further consideration the Department made a determination that the provision requiring oral explanations would not significantly advance the Department's policy goals and would have limited effectiveness as an enforcement tool due to the difficulty in ascertaining what was actually said by the parties. Of course, the Department strongly encourages applicants to use the disclosure form as a basis to ask licensees questions regarding their loan terms and conditions and the Department anticipates such a dialogue will occur.

**22. Comment.** Commentators have also suggested that the required disclosure form be made available in the primary language of the applicant, similar to requirements contained in 73 P.S. § 201-7(b). (43, 50)

**Response.** The statute referred to by the commentators, 73 P.S. § 201-7(b), regulates fair trade and business practices and requires certain documents associated with a sale be in the same language as used in the oral sale presentation. The provision also requires a notice of cancellation in the same language as the contract. *Id.* The commentators seem to request that the Department go further and require licensees to make a determination as to what the primary language of the applicant is and have the disclosure form issued in that language. The Department believes that such a requirement would have to be statutorily mandated; however, the Department will initially make the disclosure form available in Spanish and may in the future provide the form in other languages for licensees to download and use.

**Section 46.2(b)**  
**[Final-Form § 46.2 (b)]**

**23. Comment.** Several commentators have indicated that the information required to be disclosed on the required disclosure form is not known by lenders and/or brokers at the time of the required issuance. (7, 37, 39)

**Response.** The Department believes that the information required by its disclosure form, timed to be issued with federal disclosures, is known or reasonably determinable by licensees at the time the application is completed. The Department recognizes that a loan transaction is a fluid transaction and the terms and conditions of the loan may change. Therefore, the re-disclosure provisions were drafted to address any changes that may occur after the initial disclosure form is issued.

**24. Comment.** Two commentators have expressed concerns regarding the language "contact with the applicant" which is the phrase used in this provision to identify who is responsible for issuing the disclosure statement. As a corollary, concern was also expressed as to whether or not the regulation required licensee lenders and brokers to both issue the disclosure form. (37, 50)

**Response.** In response to the comments received, the Department has deleted the “contact with applicant” language. The provision has been revised to require the licensee “who takes the application” to issue the disclosure form. This language is intended to make clear that the licensee who is in direct contact with the applicant and works with the applicant in completing the application is primarily responsible for issuing the disclosure form. In most, if not all, circumstances where there is a mortgage broker involved, it will be the mortgage broker who will be required to issue the disclosure. However, the Department has inserted a new section in the Final-Form Regulation that permits a broker to defer issuance of the disclosure form to a lender, provided that the lender complies with the disclosure requirements in the regulation. See Final-Form Regulation, Section 46.2(f).

**25. Comment.** Two commentators have requested that the Department clarify the obligation of licensees to have the disclosure form signed and dated and these commentators have inquired whether or not the provision requires the form to be signed and dated by the applicants within three business days. (37, 50)

**Response.** The Department has revised the proposed regulation and drafted a new subsection to address the timing of the issuance of the disclosure form and the requirement that applicants sign and date the form. Under the Final-Form Regulation, Subsection 46.2(c) requires a licensee who takes the application to sign and date the form and deliver or mail the disclosure form within three business days after the application is received or prepared by the licensee. Final-Form Regulation Subsection 46.2(e) requires licensees to have the applicant sign and date the disclosure form within ten business days after delivery or mailing.

**26. Comment.** Several commentators have asked that the Department require disclosures for fees associated with the loan transaction. (7, 42, 43)

**Response.** The Department chose to avoid creating fee disclosure requirements parallel to federally required disclosures. Instead, the Department focused on certain aspects of the loan transaction with minimal additional paperwork and burden placed upon licensees, particularly when there are proposed revisions to the federal disclosures aimed at making the existing federal fee disclosures more transparent. The Department will monitor the proposed revisions of the required federal disclosures to determine if further revisions are needed once the federal disclosures are promulgated.

**27. Comment.** A commentator supports the disclosure requirement but requests industry input into the form. (10)

**Response.** As with the formulation of the regulation, the Department intends to consult with industry and consumer representatives during the implementation stage of the regulation on the appearance of the disclosure form to be required.

Section 46.2(b)(2)  
[Final-Form § 46.2(b)(2)]

**28. Comment.** Two commentators have expressed confusion regarding the purpose and utility of the “lock-in” agreement disclosure requirement. (3, 12)

**Response.** Under the Mortgage Act, licensee brokers are not permitted to (1) enter into a lock-in agreement with the applicant in the licensee’s own name and (2) receive fees for lock-in agreements with consumers. 7 Pa.C.S. § 6123(7). Only mortgage bankers and loan correspondents under the Mortgage Act may enter into lock-in agreements with applicants and receive fees from such applicants. However, mortgage brokers may provide to applicants the lenders’ lock-in agreements for execution.

The Department has received complaints from consumers regarding the use of lock-in agreements and discovered through examinations that some mortgage brokers have entered into lock-in agreements with applicants in their own name. In addition to being a violation of the Mortgage Act, the danger for consumers who enter into lock-in agreements with mortgage brokers is that the broker does not fund the loan or set the interest rate. If a lender decides to increase the interest rate and there is no agreement between the applicant and the lender, the applicant may not have recourse against the lender to enforce the purported locked-in rate. This issue has arisen when mortgage bankers would enter into lock-in agreements with mortgage brokers (not applicants) and the mortgage banker would later dishonor the agreed rate, leaving the consumer with a higher interest rate and little recourse. By requiring the disclosure of the ability of the licensee to enter into lock-in agreements with the applicant, the Department believes that mortgage brokers will be reminded that they cannot enter into lock-in agreements with applicants in their own name. Applicants will also be made aware that mortgage brokers are prohibited from entering into lock-in agreements in their own name. These issues were also highlighted and addressed in a September 2, 2003, Secretary’s Letter issued by former Secretary of Banking A. William Schenck III and available on the Department’s website at [www.banking.state.pa.us](http://www.banking.state.pa.us).

Section 46.2(c)  
[Final-Form § 46.2(c)-(e)]

**29. Comment.** Two commentators have asked for clarification on whether or not the disclosure form, when used for re-disclosure after an initial disclosure, must be signed and dated by applicants. (37, 50)

**Response.** The Department has clarified the disclosure requirements under the regulation and new Section 46.2(e) of the Final-Form Regulation requires the signing and dating of the disclosure form by applicants when used as an initial disclosure or for a re-disclosure pursuant to Section 46.2(d) of the Final-Form Regulation.

General Comments to Section 46.2(e)  
[Final-Form§ 46.2(g)]

**30. Comment.** Numerous have asserted the ability to repay provisions are not needed because market conditions in the mortgage industry are correcting the deficiencies that the Department is primarily seeking to address, specifically, the practice of lenders and brokers providing mortgage loans to borrowers who did not have the ability to repay the loans they were given. (3, 8, 9, 10, 6, 21, 22, 25, 28, 31, 33, 34, 46, 47)

**Response.** The Department agrees that current mortgage market conditions have seriously restricted mortgage lending in the United States and, specifically, the use of stated income or no documentation loan products. The current market constrictions regarding these loan products are based in large part upon the dangerous lending and brokering practices that evolved over the last ten years, in particular, the practice of ignoring whether borrowers have any reasonable ability to repay the loans they were offered. Indeed, the comments that market conditions are correcting for these unsound practices tacitly acknowledge that there were a great deal of imprudent decisions and improper conduct on the part of lenders, brokers and consumers in the mortgage loan arena. The past several months since the public comment period ended clearly highlight, in the most dramatic fashion, the excess and unsound practices in the mortgage industry that contributed to the current distress in the housing market and the economy as a whole.

The Department does not believe that the response to this crisis, and the harm caused, should be that of inaction. Instead, the Department believes that unless the practices of lending and brokering without regard to an applicant's ability to repay are addressed now, through responsible regulation, such practices will only return when market conditions permit. To ignore what has led up to the current crisis in the mortgage industry and hope that "market corrections" will instill in mortgage professionals a degree of prudence and responsibility in mortgage loan transactions would be imprudent. In fact, it is the Department's belief that the regulation's ability to repay provisions will provide a future stabilizing force in the market by providing a degree of assurance to investors and lenders in the secondary market that Pennsylvania licensees gave due consideration to an applicant's ability to repay the offered loan.

**31. Comment.** One commentator has asserted that the regulation's ability to repay provision requires licensees to predict the future through a crystal ball. (37)

**Response.** The Department believes that the requirements of the regulation do not require licensees to predict each and every event or circumstance that may affect a borrower's ability to repay and what might happen "down the road." Instead, the regulation asks licensees to make a reasonable analysis as to whether or not the borrower will have the wherewithal to repay the loan based upon facts and circumstances known at the time of the loan origination.

**32. Comment.** Several commentators have asserted that the ability to repay provisions will eliminate credit options. (6, 10, 24, 34, 35)

**Response.** The Department does not believe that the consideration and documentation of an applicant's ability to repay a loan will eliminate credit options for Pennsylvania borrowers. The question is not whether credit options are eliminated for an applicant, but whether or not an applicant can afford the credit options that are available. No purpose is served by providing loans to applicants that they cannot afford and that will ultimately drive them from their homes when they are unable to make payments.

33. **Comment.** Some commentators have asserted that the ability to repay provisions of the regulation will affect the ability of homeowners to refinance existing loans that are now beyond their means. (14, 21, 27, 35)

**Response.** The Department acknowledges that certain borrowers may not be able to refinance an existing loan to the extent that they do not have the ability to repay the loans offered to replace their current loans.

34. **Comment.** One commentator has suggested that the regulation is "dangerous" and the Department should rely upon national guidelines. (3)

**Response.** The Department sought to make the regulation consistent with the guidance issued by federal regulators and the Conference of State Banking Supervisors and American Association of Residential Mortgage Regulators ("CSBS/AARMR") regarding non-traditional and sub-prime mortgage lending. The Department believes that the regulation is consistent with these national guidelines, differing only as to documentation. However, the Department believes that, while the federal and CSBS/AARMR guidance is helpful, a binding regulation is required to appropriately address improper practices in mortgage lending and brokering.

35. **Comment.** Two commentators have expressed concern about the possible effect of the regulation on minorities and whether or not the regulation will have a discriminatory effect. (27, 33)

**Response.** Under the regulation all applicants will be subject to the same standard and the Department does not believe that the regulation will have a discriminatory effect on minorities. The Department believes that the regulation serves a legitimate purpose and is necessary for the safety and efficiency of the mortgage business. Under the regulation, only those applicants who are reasonably determined to be unable to repay an offered loan will be affected. The Department will continually review the effect of the regulation on licensees and Pennsylvania citizens following its promulgation to ensure that the regulation performs as intended.

36. **Comment.** One commentator has expressed concern that the ability to repay provisions of the regulation will increase staffing levels and costs to borrowers because many of the loans they offer are underwritten based upon automated underwriting software and, under certain criteria, only require verbal verification of employment. (4)

**Response.** The ability to repay provisions of the regulation require licensees to verify and document an applicant's fixed expenses and income and, therefore, licensees may have to

change or supplement the manner in which current underwriting software is utilized to conform to the required analysis, which may include increasing staff. In verifying information, the Department has chosen to leave the manner of verification to the licensee to provide the most flexibility to the industry. After review of the comment, the Department does not believe that the regulation would necessarily prohibit verbal verifications of employment. So long as the licensee appropriately documents in its file the circumstances of the verification so that the Department may confirm the verbal verification occurred and was proper, the Department would at this time consider this as a form of verification under Section 46.2(g)(4). However, the Department does have concerns regarding verbal verifications of this type and reserves the right to reexamine this issue if it becomes apparent that such verbal verifications are being abused or manipulated and to require licensees to obtain written verifications of employment in the future on a case-by-case basis. The Department notes that the comment does not specify if the actual income of the applicant is also verified in the verbal exchange or if the licensee has other documentation of the applicant's income such as tax returns, account statements and/or W-2 or 1099 forms. Verbal verifications of income would not be sufficient when verifying and documenting income pursuant to Section 46.2(g)(2).

**37. Comment.** One commentator has asserted that a borrower with the following characteristics would not be able to receive a \$13,000 loan under the regulation: (a) Owns home free and clear; (b) bought home for \$66,000 in 1995; (c) \$3,000 in real estate taxes due; (d) needs \$10,000 to buy a car; (e) has no job because he needs a car; and, (f) receives \$900 a month from a rental property. (1)

**Response.** Initially, the Department notes that the scenario presented lacks sufficient detail on other various circumstances that would be calculated in an ability to repay analysis. Factors such as a borrower's fixed expenses, the loan products that may be available to the applicant and how much income after fixed expenses is available are not addressed. The Department finds the scenario difficult to address given the limited facts proffered. For instance, does the borrower need to purchase a car for a job that has already been offered. In such a case, licensees would be allowed to consider the job offer in the ability to repay analysis. But, notwithstanding the forgoing, the Department fully understands that under the ability to repay provisions of the regulation it is entirely possible that licensees may determine that certain applicants do not have the ability to repay offered loans. Therefore, in the proffered scenario, the borrower may not qualify as having the ability to repay the offered loan.

**38. Comment.** Several commentators have requested that the ability to repay provisions of the regulation include within its coverage "covered loans" as defined in Chapter 5 of the MBBCEPA ("Chapter 5"). (41, 43, 50)

**Response.** The Department believes that the General Assembly addressed the treatment of covered loans and the obligations of licensees through the provisions of Chapter 5, which already contain an ability to repay analysis that would conflict with the regulation. The Department will continue to review the scope of the regulation going forward and periodically assess whether regulations under Chapter 5 are warranted. The Department also notes that through its mortgage foreclosure studies, it has recommended that the General Assembly re-examine the provisions of Chapter 5 in light of the study's findings.

39. **Comment.** Another commentator has suggested that the regulation be limited to only "covered loans" as defined in Chapter 5 of the MBBCEPA. (39)

**Response.** As discussed above, Chapter 5 of the MBBCEPA already contains an ability to repay analysis for covered loans that would conflict with the ability to repay provisions of the regulation. But more importantly, the Department believes that covered loans constitute a small percentage of residential loans made and it is essential to address both purchase money loans, which, by definition, are not "covered loans," and also non-purchase money loans which do not meet the covered loan criteria.

40. **Comment.** One commentator has asserted that the regulation will hurt his business of purchasing properties for rehabilitation and then selling them because he would no longer be able to use stated income and/or no doc loans to purchase his properties. (32)

**Response.** Loans used for commercial purposes are not within the coverage of the Mortgage Act or CDCA. Therefore, to the extent that the commentator is obtaining loans to rehabilitate properties for resale, those loans would be for a commercial purpose and would not be subject to the regulation.

41. **Comment.** Two commentators have expressed concern that the regulation will place Pennsylvania licensees at a disadvantage with federal competitors because federally regulated entities will not be subject to the provisions of the regulation and would be able to offer true stated income and no or low documentation loans without verifying income or fixed expenses. (25, 37)

**Response.** The Department does not believe that the impact of the regulation will be significant with regard to the limitations concerning stated income or no/low documentation loans. Because of the current housing crisis and the cascading effect the meltdown of the mortgage market has had on the secondary market and the economy as a whole, the general use of these types of products have been severely restricted, which has been noted by many commentators. Moreover, federally regulated entities are already operating under the federal agency versions of the non-traditional and sub-prime guidance, which incorporate an ability to repay analysis calculated in the same manner as the regulation, except for the documentation requirement. As a result, Pennsylvania licensees will contribute prudently underwritten loans to the secondary market and economy. The Department will closely monitor the effects of the regulation and continually evaluate the impact on the regulation on its licensees and Pennsylvania consumers.

42. **Comment.** Many commentators have commented in various ways that the regulation will prevent borrowers in Pennsylvania from obtaining loans. In particular, commentators assert that the verification requirements of the regulation will prevent individuals in certain types of professions from receiving loans, specifically, individuals who are self-employed, seasonal workers, small business owners, tipped borrowers, commission borrowers or other individuals where income cannot be proven through traditional means. (24, 25, 35, 36, 38) In a related comment, a commentator has stated that the "stated income" and "no-doc" loans are intended for

self-employed people that may not report all of their income and these individuals will be unable to obtain loans. (34)

**Response.** Initially, the Department notes that the definition of income is gross income as defined in 26 U.S.C. § 61 (relating to definitions). This is an extremely broad and all-encompassing definition of income that the Department does not believe would exclude any of the income earned through the professions referenced in the comments. Second, the Department is not limiting verification to “traditional” means, presumably meaning tax returns. Clearly, tax returns are the easiest and most effective means to prove income, when available. Notwithstanding the obvious preference of using a tax return for verification, the Department is aware that there are circumstances that a tax return might not be readily available or reflective of the current income of the applicant, such as, for example, an individual who has less than one year of employment. Therefore, documentation other than a tax return which evidences the income the individual is relying upon to repay the loan is acceptable in the appropriate cases. While the Department acknowledges that the loan process under the regulation may, for certain individuals or professions, require additional effort to produce the needed verification documentation, the Department does not believe that they will be prohibited from receiving a loan by this fact alone.

Many of the commentators on this point do not fully explain why borrowers will not be able to get loans without these products. The Department suspects that the larger issue, as explicitly referenced by one commentator, involves individuals that do not fully report their income to the appropriate taxing authorities. These individuals may not wish to use their tax returns as part of the verification process because the returns would not reflect the income they truly earn. Individuals who do not report all of their income as required under state and federal law will likely face difficult choices if they must rely upon unreported income to repay the offered loan. The need to provide documentation of income that is not reported to licensees for the loan analysis will undoubtedly present certain legal risks to these applicants; however, the regulation would not prevent them from doing so. To the extent that commentators are suggesting that the Department consider the effects of the regulation on individuals who evade taxes, the Department believes that to do so is inconsistent with the Department’s role as a Commonwealth agency and regulator.

**43. Comment.** One commentator has indicated that licensees need a safe harbor under the ability to repay provisions of the regulation. (12)

**Response.** In analyzing the possibility of the inclusion of a safe harbor in the regulation, the Department determined that a safe harbor was not feasible because any single safe harbor trigger would either be so low so as to eliminate the applicability to the majority of loans or be so high so as to be ineffective at providing an actual safe harbor. Moreover, the Department determined that a safe harbor reliant upon one trigger, such as a debt-to-income ratio or a credit score, would ignore the complexity of the various factors that may have relevance to an ability to repay analysis. For example, it is possible someone with a high credit score still may not reasonably be expected to be able to repay an offered loan. To predict what combination of the various factors that, if combined, would provide an effective and fair safe harbor would be overly complex and unworkable.

However, the Department has drafted a new section, 46.3, which provides that if a loan is made in good faith in conformity with an interpretation of this chapter by the Department or the courts of this Commonwealth, no penalty for a violation of this chapter shall apply, notwithstanding that after the loan is consummated, such interpretation is amended, rescinded or determined by a judicial authority to be invalid for any reason. This provision mirrors a similar provision in the CDCA.

**44. Comment.** Several commentators have asserted that subsections 46.2(e)(1) and (e)(2) of the regulation will eliminate reverse mortgages. (15, 16, 17, 18, 50)

**Response.** The Department agrees and has revised the proposed regulation to include an exemption for reverse mortgages in the Final-Form Regulation.

**45. Comment.** Two commentators have suggested that the ability to repay provisions would impede the use of certain streamlined products offered by the Federal Housing Authority. (15, 39)

**Response.** As a result of this comment and another comment to Section 46.2(f)(3), which addresses loan refinances, the Department has carefully considered the impact the regulation would have on certain products or programs offered by the United States Veteran's Administration ("VA"), the Federal Housing Authority ("FHA"), Fannie Mae and Freddie Mac. The Department believes that the underwriting guidelines and loan specifications for FHA and VA loan programs are consistent with the Department's intent regarding the ability to repay analysis and, therefore, loans that are insured or guaranteed or offered through these programs have been exempted from the ability to repay provisions of the Final-Form Regulation. However, the Department does not believe an exemption for loan programs offered through Fannie Mae and Freddie Mac is appropriate because of the different objectives and policies of these entities, as well as their quasi-governmental status, as opposed to FHA and the VA. The Department will monitor the effect of this exemption scheme after the regulation is implemented.

**46. Comment.** One commentator has expressed concern that the ability to repay provisions of the regulation could be interpreted to prohibit loans with a balloon payment feature. (39) Several other commentators requested that the regulation should clarify how the ability to repay analysis would be performed for loans with a balloon payment feature. (40, 41, 43)

**Response.** The Department recognizes the utility of balloon payments in the correct circumstances and has drafted a new provision in the Final-Form Regulation to address loans with balloon payment features. See Section 46.2(g)(9). Loans with balloon payment features should be prudently used and offered by licensees only in the appropriate circumstances. Therefore, the regulation requires licensees to review an applicant's ability to repay the monthly payments up to and including the balloon payment, and the general ability of the applicant to make the balloon payment itself. The Department does not expect the licensee to predict the resources and income of the applicant with exact certainty and recognizes that the farther the balloon payment is from loan consummation the more difficult it is to do an ability to repay analysis. However, the Department believes in certain circumstances the licensee can reasonably

foresee that an applicant may not have the ability to make the balloon payment, in particular, when the balloon payment is due in close proximity to the loan consummation, such as two years or less.

**47. Comment.** One commentator has suggested that homeownership will decrease under the regulation because applicants will not be able to use low documentation loans. (21)

**Response.** The Department disagrees that home ownership will decrease because of the constraints placed upon low documentation loan programs by the income and expense verification requirements of the regulation. As discussed previously, while the verification requirements may require applicants to produce additional documentation, the verification requirement alone is not a barrier to home ownership and is in fact designed to foster home ownership and decrease loan defaults and foreclosures.

**48. Comment.** A commentator has alleged that borrowers will no longer be able to use Fannie Mae and Freddie Mac conforming loan programs. (21)

**Response.** The commentator does not fully explain the reasoning behind this assertion. The Department believes that these programs will still be available to borrowers under the regulation. However, licensees may be required to obtain and retain additional documentation for their own files that Fannie Mae and Freddie Mac programs may not require to be submitted to them.

**49. Comment.** Another commentator has suggested that homeownership will decrease because existing homeowners will be unable to move into more expensive homes and, as a result, there will be fewer homes to be sold as starter homes for first-time home buyers. (25)

**Response.** Again, the purpose of the regulation is to have licensees consider the reasonable ability of the applicant to repay any loans that are offered. To the extent that applicants would not have this ability with a more expensive property, they may not be able to receive a loan.

**50. Comment.** One commentator has asserted that mortgage brokers are not qualified to perform the ability to repay analysis, they simply collect and organize data. The commentator goes on to state that if brokers are required to perform the analysis, the Department should provide a worksheet to assist brokers. (28)

**Response.** The Department believes that licensed brokers are, and should be, capable of performing the analysis required by the regulation as professionals in the mortgage industry and the primary, and sometimes only, contact a borrower has during the loan transaction. The Department intends to consult with industry representatives during the implementation of the regulation and will discuss developing additional documentation that may help licensees comply with the regulation. Brokers may also consider utilizing underwriting formulas used by their lenders as part of their ability to repay analysis.

However, the Department has revised the ability to repay requirements by adding Section 46.2(i) in the Final-Form Regulation to address the responsibilities of licensees when there is a material change in the loan terms or conditions after they have initially done the required analysis. Under the new section, if there is a material change in facts or circumstances regarding the loan transaction that would affect an applicant's ability to repay after the licensee has performed an initial ability to repay analysis the following is required: (1) a licensee broker is required to send a notice to the applicant disclosing what the material change is and that the change may affect the applicant's ability to repay the offered loan, and (2) a licensee lender is required to perform another ability to repay analysis in accordance with the regulation. Material changes that would affect an applicant's ability to repay may include an increased interest rate, larger borrowed principal amount, inclusion of a balloon payment or a prepayment penalty or the loss of the applicant's employment. Certainly, any time a required re-disclosure under the disclosure provisions of the regulation is required this provision may be triggered.

The Department drafted this provision to clarify the continuing obligations of licensees under the ability to repay provisions. In the proposed regulation, all licensees would have been required to constantly perform the ability to repay analysis up and to the point the loan closes. The Department believes that such a continuing obligation imposed upon mortgage brokers would be unfair and problematic because, after the initial analysis is performed, there may be material changes made by either the lender or applicant up to and until the time of closing, without warning or advance notice to the broker.

**51. Comment.** One commentator asserts that the ability to repay requirement will subject licensees to additional consumer lawsuits. (45)

**Response.** The Department believes this risk is a cost of doing business, faced in any industry or profession that is regulated. The financial services industry has, and will continue to be, exposed to consumer litigation regardless of the proposed regulation.

Section 46.2(e)(1)  
[Final-Form § 46.2(g)(1)]

**52. Comment.** Several commentators have requested that the Department require the maximum loan interest rate of the offered loan be used in the ability to repay analysis instead of the fully indexed rate. (41, 43, 50)

**Response.** The Department believes that the fully indexed rate represents a balanced compromise between any initial teaser rate and the possible maximum loan rate. The Department believes that the use of the maximum interest rate is not an appropriate rate to judge an applicant's ability to repay at the time the loan is consummated. The use of the maximum loan interest rate would set an unreasonable bar for applicants to overcome. Furthermore, the use of the fully indexed rate is consistent with the federal guidance and the guidance provided in other states. The Department believes that the use of the maximum interest rate would place too much of a competitive disadvantage on licensees and ultimately hurt consumers.

Section 46.2(e)(2)  
[Final-Form § 46.2(g)(2)]

**53. Comment.** Many commentators have asserted that the requirement to verify income and fixed expenses in the regulation will eliminate loan products such as stated income and no documentation loans, which are asserted to be useful and appropriate products. (2, 6, 10, 11, 14, 20, 19, 21, 22, 25, 29, 30, 32, 34, 36, 37, 38, 45, 46, 48, 49)

**Response.** The commentators are correct that the verification requirements of the ability to repay provisions of the regulation will prohibit licensees from offering a loan without verifying the income and fixed expenses of applicants. The policy goal of the ability to repay provisions of the regulation is to ensure that licensees conduct a reasonable analysis of the borrower's financial situation in order to determine if the borrower has the ability to repay the offered loan. In drafting the provisions, two factors stood out as having the most direct impact on an applicant's ability to repay: income and fixed expenses. Because of the importance of these two factors, the regulation requires their verification. As a result, a licensee's loan product that currently does not require a licensee to verify income and fixed expenses will be effectively prohibited. Therefore, although there may still be true "no-doc" and "stated income" product loans offered in Pennsylvania by entities not covered by the regulation, licensees will still be required to perform the verification requirements of the regulation which effectively eliminates the purpose of these loans. The Department believes that the convenience of these types of loans, even for those individuals who use the products appropriately, is far outweighed by the larger potential for abuse and the catastrophic harm caused to families who end up in homes they cannot afford and face serious credit risk as well as foreclosure when they are unable to make their loan payments.

On a related note, commentators have also in various comments mentioned "low-documentation" loans, a broad type of loan product that is purported to require minimal documentation. Under the regulation, these loans will also be affected to the extent that such minimal documentation loans do not include verification of income and fixed expenses. It should also be noted that if other information in addition to income and fixed expenses is considered as part of a licensee's analysis, under Section 46.2(g)(4) of the Final-Form Regulation, such other information must be documented by the licensee in the loan file. Therefore, it is possible that the documentation of additional information other than income and fixed expenses may require more documentation than certain lenders currently require for their loan products.

**54. Comment.** Commentators have asserted that the main reasons for foreclosures continue to be traditional reasons such as the loss of a job, medical emergencies and divorce and that stated income or no documentation loans are not a problem or that there is no certainty that stated income or no documentation loan products are responsible for increased foreclosures. (3, 6, 11, 14, 19, 34, 35, 36, 46, 49)

**Response.** The Department recognizes that much has changed in the past several months since the time of the submission of these comments. It is now clear that the proliferation of loan products that were offered without any consideration of the borrowers' ability to repay was, and

is, a substantial reason for foreclosures in the United States and the single most cited factor when discussing the collapse of the sub-prime mortgage market, which has had a cascading effect throughout the economy. The practice of providing loans without prudent underwriting was driven by the use of products such as stated income and no documentation loans. Borrowers, lenders, brokers and investors were able to manipulate and abuse stated income and no documentation products to the detriment of the entire country. While in limited circumstances these products may have been useful for certain borrowers, the Department believes that the potential for abuse outweighs any convenience the products offer. As discussed below, the Department does not believe the verification of the required factors presents a significant hurdle to borrowers or licensees.

**55. Comment.** Two commentators have suggested that by mandating verification of income and fixed expenses, that the Department is requiring the use of full documentation programs that requires certain factors, such as minimum history of employment. (10, 22)

**Response.** The Department is not imposing a minimum employment history through the regulation. Certainly, the length of employment may be an additional factor in considering whether or not there is an ability to repay. The Department is not requiring any factors or minimum requirements other than the ability to repay at the time of loan offering based upon a reasoned analysis of income, fixed expenses and other applicable factors.

**56. Comment.** One commentator has asserted that a mortgage broker she went to for the purpose of obtaining a loan informed her that if the regulation was promulgated she would not be able to obtain a no income verification loan. (23)

**Response.** As the Department has discussed, licensees could not offer no income verification loans offered by lenders without the licensee complying with the verification requirements of the regulation. The Department notes that the commentator indicated that she had income from a job, cash income from her husband and would share expenses with her sister who will move in with her. The Department believes that all of these factors could be considered and relied upon when performing an ability to repay analysis under the provisions of the Final-Form Regulation. Therefore, the commentator may still qualify for essentially a no income verification loan product so long as she provides to the licensee the correct documentation regarding her income and fixed expenses, and any other factor relied upon for repaying the loan.

**57. Comment.** One commentator has asserted that many borrowers will not be able to easily get their records in order to satisfy the regulation's verification requirements and as a result will lengthen the time it takes to obtain a loan. (22)

**Response.** While the Department recognizes that certain borrowers may have to gather various documents during the loan application process which may take additional time, the Department does not believe that the documents most often likely to be required are difficult to obtain. For example, the Internal Revenue Service ("IRS") has a program called Income Verification Express Service whereby the IRS can provide a return transcript, W-2 transcript and 1099 transcript information generally within 2 business days to a third party with the consent of the applicant.

**58. Comment.** One commentator has stated that certain individuals who have significant wealth will not want to document all of their income in order to obtain a loan. (36)

**Response.** The Department has taken this comment into account and has added section 46.2(g)(3) of the Final-Form Regulation which provides that only income that the applicant is relying upon to repay the offered loan must be verified. Therefore, applicants are not required to verify all sources of income to the extent they will not be relying upon this income to repay the offered loan.

**59. Comment.** One commentator has requested that the debts to be considered be limited to those debts on the credit report. (12)

**Response.** The Department's definition of fixed expenses was drafted so that most, if not all, of the debts will be reflected on a credit report or disclosed by the borrower on the Form 1003 Mortgage Loan Origination Agreement. Credit reports will be permitted by the Department to be used as a verification tool for fixed expenses for those debts that are listed on the report. For debts which may not be reflected on a credit report, the Department believes that applicants will have documentation available to support the verification of the debts or which can be obtained without significant difficulty.

**60. Comment.** Several commentators have noted that there is no definition for fixed expenses and income, making the requirements of the regulation unclear and vague. (12, 39, 50)

**Response.** The Department has drafted a definition for fixed expenses as follows: "any debt obligations, revolving charge accounts, alimony payments, child support payments, payments pursuant to a separate maintenance agreement, housing association fees and property taxes and hazard insurance on the property to be mortgaged, whether or not such property taxes and hazard insurance are required to be escrowed." See Section 46.1 of Final-Form Regulation. The Department has adopted the definition of gross income as defined in the Internal Revenue Code, a definition which encompasses all forms of income.

**61. Comment.** Several commentators have requested that the Department ensure that the ability to repay analysis performed by licensees specifically include consideration of hazard insurance and property taxes. (7, 40, 42, 43)

**Response.** The Department has drafted a definition of fixed expenses to include both hazard insurance and property taxes and, therefore, these elements are required to be considered by licensees when reviewing an applicant's ability to repay.

**62. Comment.** Several commentators have requested that the Department mandate that prepayment penalties be factored into the ability to repay analysis. (7, 43, 41)

**Response.** The Department believes that requiring prepayment penalties to be considered in all loan offerings is unduly restrictive. Such a requirement may significantly restrict the ability of applicants who do not intend to take action in the near future that would

trigger the prepayment penalty. However, Section 46.2(g)(7) of the Final-Form Regulation prohibits a licensee from ignoring facts or circumstances that the licensee knows or reasonably should know would indicate that an applicant does not have the ability to repay. Therefore, to the extent that the licensee is aware of or reasonably should be aware of certain facts or circumstances, such as the applicant needing to refinance or sell during the prepayment penalty period, a licensee must consider this as part of an ability to repay analysis.

**63. Comment.** One commentator has asked that the Department consider alternatives to the regulation such as requiring borrowers to acknowledge that the information contained in a loan application is based upon actual circumstances. Presumably, this is an offered alternative to the verification requirements licensees must perform under the regulation. (3) In a related comment, another commentator has suggested that consumers should be held responsible for their actions and judgment. (10)

**Response.** The Department recognizes that certain applicants may supply false or exaggerated information in an attempt to obtain a loan. Current forms used throughout the mortgage process already require applicants to answer truthfully. For example, a standard 1003 mortgage loan origination agreement contains a provision advising applicants that the information submitted is done under penalty of federal law. Unfortunately, the penalties do not appear to deter inappropriate conduct by applicants. Furthermore, the Department does not have the jurisdiction to pursue actions against consumers who do not provide full and accurate information on loan applications. The Department believes that the verification requirements will benefit licensees by encouraging applicants to truthfully and responsibly provide accurate information that a licensee can rely upon.

**64. Comment.** A commentator has requested that the regulation exempt from its coverage certain loans that are processed through underwriting software from Freddie Mac and Fannie Mae and similar programs on the basis that these programs are currently used with success and do not require verification of information. (4)

**Response.** The Department does not oppose the use of automated underwriting programs and the responsible use of these programs should not conflict with the requirements of the regulation. However, the Department believes the verification requirements are essential to the licensee's ability to offer loans that are able to be repaid by the applicant. The Department understands that the verification requirements of the regulation will require adjustments to the business practices of licensees who rely solely on automated systems.

Section 46.2(e)(3)  
[Final-Form § 46.2(g)(4)]

**65. Comment.** One commentator has questioned what other factors licensees may consider when performing an ability to repay analysis, other than income and fixed expenses. (50)

**Response.** Section 46.2(g)(4) of the Final-Form Regulation was drafted to give licensees flexibility in considering factors other than income and fixed expenses when performing an ability to repay analysis. This provision is intended to permit licensees to document information

in addition to income and fixed expenses such as: payment history, family gifts, non-collateral assets, seasonal business considerations, business history with lender/broker, new job start date, job relocations, etc. So long as the other considerations are reasonably related to an applicant's ability to repay and documented by the licensee so that the Department can review the analysis, licensees may consider such additional information.

**66. Comment.** As a corollary to the previous comment, many commentators have stated that under the ability to repay provision, certain factors now considered when offering a loan will no longer be able to be utilized, such as payment history, seasonal income and the averaging of income for seasonal or commissioned workers. (27, 28, 32, 33, 38, 49)

**Response.** To the contrary, all such factors may be considered when assessing the applicant's reasonable ability to repay the loan being offered by the licensee. Initially, it should be noted that the new definition of income includes virtually any income that an applicant may receive, whether or not it is seasonal, commissioned, rent payments, etc. The Department believes that in analyzing the income that an applicant receives, a licensee is entirely justified in also considering additional factors such as the seasonal nature of the income, debt payment history, commission history, and if used prudently, census and wage information by profession to anticipate reasonable increases of income over time. However, licensees must be able to articulate the reasoning and basis for the use of such other information to the Department and how it was used when considering the applicant's ability to repay.

**67. Comment.** One commentator has asserted that this subsection is too vague and does not provide appropriate guidance to licensees. (33)

**Response.** The Department believes that if it were to require specific other factors that licensees may consider, there is a risk of: (1) restraining the flexibility of licensees from using certain tools or factors in their analysis which the Department did not envision at the time of promulgation, or, (2) encouraging licensees to manipulate the factors that are enunciated to justify the offered loan. The Department intends to work with licensees during the implementation stage of the regulation to make sure licensees understand the provisions of the regulation and to ensure compliance.

Section 46.2(e)(5)  
[Final-Form § 46.2(g)(6)]

**68. Comment.** Two commentators have requested the Department clarify how long records required by the regulation must be maintained. (37, 50)

**Response.** The Department considers that any records required by the regulation fall under record preservation requirements of the Mortgage Act and the CDCA. See the Mortgage Act, 7 Pa.C.S. § 6135(b), and the CDCA, 7 P.S. § 6209.

**69. Comment.** One commentator has expressed concern that this subsection may eliminate automated underwriting. (37)

**Response.** The Department is not entirely sure how the records retention requirements of this provision could lead to the elimination of automated underwriting software. To the best of the Department's knowledge, there have not been any records retention compliance issues under the Acts based upon a licensee's use of automated underwriting software. To the extent that automated underwriting software is involved in the ability to repay analysis requirements of the regulation, the Department does not foresee any conflict with this provision of the regulation. Essentially, the purpose of this provision is to ensure that the Department is able to examine and understand a licensee's ability to repay reasoning by having relevant documentation in a borrower's loan file. To the extent that processes regarding the calculation of ability to repay are performed by automated software, licensees would need to explain to the Department how the software is used in their analysis.

Section 46.2(e)(7)

[Deleted from Final-Form Regulation]

**70. Comment.** Two commentators have questioned the purpose and effect of the Department's inclusion of this provision which refers to the CSBS/AARMR guidance on non-traditional mortgage products that was previously sent to all licensees by the Department. (12, 50)

**Response.** The Department has deleted this provision from the regulation after consideration of the comments.

Section 46.2(f)(1)

[Final-Form § 46.2(j)(1)]

**71. Comment.** One commentator has expressed concern over the Department's use of the terms "imply" and "relevant" in this provision. (12)

**Response.** The term "imply" is used to cover circumstances where there is no explicit or overt act on the part of the licensee but, instead, an indirect act expressed by inference. The term "relevance" is meant to convey that licensees should not advise applicants that income is not related to, or has no bearing, upon an applicant's ability to repay the loan. The Department believes that this provision is sufficient as drafted in the proposed regulation.

**72. Comment.** Several commentators have commented that income is not relevant for reverse mortgage products and this provision would prohibit or negatively affect the offering of reverse mortgage products. (15, 16, 17, 18)

**Response.** As discussed above, the Department has exempted reverse mortgage loans from the provisions of the regulation dealing with ability to repay because the Department understands that income is genuinely not determinative of eligibility for reverse mortgage loans. However, under the majority, if not all, reverse mortgage loans, the borrower is still responsible for the payment of property taxes and insurance, as well as the maintenance of the residence. Therefore, the Department believes that, while income may not be relevant for eligibility, income is relevant to reverse mortgage loans to a certain extent and licensees originating reverse

mortgage loans should not advise applicants that income is not relevant to a reverse mortgage loan to the extent that it relates to payment of hazard insurance and property taxes.

Section 46.2(f)(2)  
[Final-Form § 46.2(j)(2)]

**73. Comment.** One commentator has questioned the utility of this provision in addition to the use of the term “imply.” The commentator has also suggested that this provision addresses a problem that does not exist. (12)

**Response.** The Department strongly disagrees with this comment. While the Department generally agrees with the commentator that legitimate lenders would not want prospective borrowers to default, all too frequently, the Department is made aware of situations where certain mortgage brokers or lenders have advised applicants to stop making scheduled payments on their existing loans or credit obligations before the new financing is in place, rather than having the borrowers continue to make payments until the new loan closes. Sometimes the new loan gets delayed, or the terms of the loan are revised or the loan falls through and the borrower is then in default under existing loan obligations. As to the Department’s use of the term imply, the Department refers to its response to Comment 72. The Department disagrees that the use of the term “imply” is not appropriate in this provision.

**74. Comment.** One commentator has commented that he generally does not understand the purpose of this provision. (3)

**Response.** The Department refers to its response to Comment 73.

Section 46.2(f)(3)  
[Final-Form § 46.2(j)(3)]

**75. Comment.** One commentator has reiterated its comments to the ability to repay provisions of the regulation contained in Sections 46.2(e) in commenting on this provision. (12)

**Response.** The Department refers to its responses to the comments to Section 46.2(e) above.

**76. Comment.** One commentator has suggested that by requiring an ability to repay analysis for refinance loans, the Department will eliminate VA loans, FHA loans, and certain unspecified Fannie Mae and Freddie Mac loan programs. (37)

**Response.** The Department refers to its response to Comment 45.

**77. Comment.** A commentator has expressed concern over the impact this provision could have on loan work-out and loan modification agreements. (37)

**Response.** To the extent that the loan modification or work-out agreement requires the recordation of a new mortgage being executed, such a modification or work-out transaction

would require the licensee to perform an ability to repay analysis. Otherwise, the loan modification or work-out agreement would not be covered by this regulation. To the extent that the commentator is expressing concern that the regulation will restrict the use of loan modification or workout agreements by lenders, the Department believes that these types of agreements are used when lenders reasonably believe that the borrower has the ability to meet the payment obligations under proposed agreements, in essence the ability to repay the loan. Therefore, the provision should have minimal effect in this scenario.

**78. Comment.** Several commentators have requested that the Department reinsert language from the regulation as published in the Advanced Notice of Proposed Rulemaking that required licensees to consider the financial resources of the applicant when refinancing and to include a suitability standard and/or more explicit rules for refinancing. (7, 40, 43)

**Response.** The Department believes that any analysis regarding the licensee's offering of a refinance loan should be consistent with the already provided ability to repay analysis. Ultimately, the most important aspect of the regulation is ensuring to the degree possible that the product being sold is reasonably able to be repaid by the applicant/borrower. Therefore, whether the loan is for a purchase of a new home or the refinance of an existing home, the Department believes the standards should be the same.

**79. Comment.** A commentator has asserted that reverse mortgages would be prohibited by this provision of the regulation. (39)

**Response.** The Department has exempted reverse mortgage loans from this subsection.

Section 46.2(f)(4)  
[Final-Form § 46.2(j)(4)]

**80. Comment.** Two commentators have expressed concern over the language of this subsection, but not the substantive effect of the provision. (12, 37)

**Response.** After review of the comments on the language of the section, the Department believes that the language is sufficient. In essence, the provision simply prohibits a licensee from offering a covered loan to an applicant without telling the applicant about alternative loans offered by the licensee that the applicant qualifies for, assuming there are such other loan products.

Section 46.2(f)(5)  
[Final-Form § 46.2(j)(5)]

**81. Comment.** A commentator has asserted that this subsection prohibits licensees from focusing borrowers on certain disclosures and more important documents. (12)

**Response.** Section 46.2(j)(5) of the Final-Form Regulation prohibits licensees from advising or implying that any required disclosures should be ignored or suggest that a document

or the execution of any document is unimportant or of no consequence. The Department has seen cases where licensees have instructed borrowers to ignore certain disclosures that have been issued or told borrowers that certain documents related to their loan transaction are not important. For example, a licensee would advise borrowers to ignore a Good Faith Estimate indicating higher interest rates or different terms than were promised, when indeed they were the actual terms of the loan that were eventually offered, thereby misleading the borrower up to the point of closing. The Department does not believe that this provision restricts licensees from focusing an applicant's attention on one or more documents. There is a difference between stating a document should be ignored or is of no importance and stating that certain documents may be more important than others.

Section 46.2(f)(6)  
[Final-Form § 46.2(j)(6)]

**82. Comment.** Two commentators have questioned what the Department means by using the term "improper" and what recourse licensees have if it is determined the execution of a document is improper. (12, 50)

**Response.** The Department believes that the types of conduct the Department deems, or would deem, improper are sufficiently illustrated by the specific practices that are set forth in the provision as (i) through (iii). A determination as to whether or not a document is considered improperly executed would be initially made by the Department's investigators, examiners or compliance staff. If the licensee disagrees with the Department's enforcement of this provision, the licensee may avail itself of its due process rights through a formal administrative proceeding wherein the licensee has the opportunity to contest the Department's position. Adverse decisions against the licensee may be appealed to the Commonwealth Court of Pennsylvania.

Section 46.2(f)(7)  
[Final-Form § 46.2(j)(7)]

**83. Comment.** A commentator has indicated that he believes already existing agreements with his funding sources cover the subject matter of this provision. (3)

**Response.** To the extent that there are already agreements used in the industry that seek to prevent the submission of false or misleading information during the loan transaction, the Department believes that the regulation will only serve to complement and support such efforts. The insertion of false or misleading information into the loan process is considered very serious and as such warrants a specific provision.

Section 46.2(f)(8)  
[Final-Form § 46.2(j)(8)]

**84. Comment.** A commentator has again questioned the Department's use of the term "improperly influence" within this provision and believes that the provision does not provide any guidance to licensees as to what is improper. (12)

**Response.** The Department believes that this provision is drafted in a manner that sufficiently advises licensees what type of conduct would be proscribed. What specific actions would come under the term “improperly influence” would be determined in the context of the standards of practice in the mortgage and appraisal industry. For guidance, licensees may refer to 10 Pa.Code § 48.3(2) of the statement of policy that was issued by the Department under the MBBCEPA and which will be re-issued under the Mortgage Act. Licensees may also refer to the Pennsylvania Department of State, Bureau of Professional and Occupational Affairs’ public comments to the Department’s Advance Notice of Proposed Rulemaking which further illustrates conduct considered improper. A copy of this is available on the Department’s website and upon request. Lastly, as is the practice of the Department, general requests for guidance as to the Department’s interpretation of its laws and regulations may be made by licensees. As with the improper execution of documents, if the licensee disagrees with the Department’s interpretation or enforcement of this provision, the licensee will be afforded the opportunity in an administrative proceeding to contest the Department’s position.

**85. Comment.** A commentator has asserted that the Department should level the playing field with real estate owned mortgage companies. (3)

**Response.** The Department is not entirely clear as to what this comment means but believes the commenter seeks to ban any affiliate relationships between licensees, realtors, appraisers, closing agents, etc. The Department notes that affiliate relationships are implicitly allowed under federal law but require affiliated business disclosures. While the Department is not prepared to ban affiliate relationships, the regulation would prohibit one entity from exerting improper influence over any other entity, including an affiliate.

**86. Comment.** A commentator has asserted that this regulation inappropriately restricts communications with appraisers and other parties to a loan. (33)

**Response.** The Department believes that the provision provides sufficient guidance to licensees and disagrees with the commentator. The Department also refers to its response to Comment 84.

Section 46.2(f)(9)  
[Final-Form § 46.2(j)(9)]

**87. Comment.** A commentator requested that the Department state what type of insurance the Department is referring to and limit the provision to only address hazard insurance. (12)

**Response.** The Department has revised the Final-Form Regulation to address only hazard insurance, which was what was originally intended.

Section 46.2(f)(10)  
[Deleted from Final-Form Regulation]

**88. Comment.** A commentator has stated that this subsection will not have any effect upon the bottom line costs of a borrower because the Real Estate Procedures and Settlement Act and

the Truth in Lending Act already prohibit charging a separate fee for required disclosures. The commentator further asserts that lenders or brokers may charge an unregulated fee for document preparation in a first mortgage loan transaction. (12)

**Response.** After review and consideration of the comment, the Department decided to delete this provision.

Section 46.2(f)(11)  
[Final-Form § 46.2(i)(10)]

89. **Comment.** A commentator has requested that the Department revise the regulation to only require compliance with this provision if the licensee knows or has reason to know it is dealing with an individual or business that is not appropriately licensed. (12)

**Response.** The Department believes that it is the duty of its licensees to conduct due diligence when forming business relationships with other brokers and lenders in Pennsylvania in order to determine whether the entity is appropriately licensed in Pennsylvania. All too often licensees do business with entities or individuals that are not appropriately licensed under the Acts, in particular, in “net branching” scenarios, where the unlicensed entities or individuals attempt to use the licensed entity’s license when in fact they should be licensed themselves under the Acts or as a branch of a licensee.

90. **Comment.** A commentator has asserted that the Department should level the playing field with real estate owned mortgage companies in this subsection. (3)

**Response.** The Department refers to its response to Comment 85.

Section. 46.2(f)(12)  
[Deleted from Final-Form Regulation]

91. **Comment.** The Department has received numerous comments regarding the advisability of this paragraph given the potential for confusion, misinterpretation and the fact-sensitive nature of what constitutes the unauthorized practice of law. (7, 12, 37, 39)

**Response.** The Department has deleted this provision because the unauthorized practice of law is better addressed by the courts of this Commonwealth and the Pennsylvania Supreme Court through its regulation of attorneys.

Section 46.2(g)  
[Final-Form § 46.2(k)]

92. **Comment.** Several commentators have asserted that the funding provisions should include exceptions for instances of the discovery of misrepresentation or fraud on the part of the borrower during the rescission period. (7, 12, 39, 50)

**Response.** Based upon the comments received regarding this provision, the Department has revised the proposed regulation to include a fraud exception in the Final-Form Regulation. Under the new Section 46.2(k), if the lender has discovered fraud on the part of the applicant after closing but during the applicable rescission period, the lender does not have to fund the closed loan as otherwise required by the subsection. However, in all other circumstances the licensee must fund the loan and funding should not be delayed because the lender failed to perform due diligence or underwriting prior to the closing of the loan.

It is the Department's position that while it is the obligation of its licensees to make a determination that the borrower has the ability to repay a loan, once the closing has occurred the lender has committed to funding the loan, except as provided by 12 CFR 226.15 or 226.23. The rescission period should not be used by a lender to reconsider the offering of the closed loans or to use the unreleased funds as leverage to extract different loan terms and conditions. Furthermore, due to the unequal bargaining power between a lender and a borrower, once the loan has closed, the Department believes the lender should bear the risk of not satisfactorily underwriting prior to closing. Lastly, the Department considers the failure to fund a loan due to alleged fraud of the applicant to be an extraordinary remedy. Because of the possible consequences a borrower may face when a loan is not funded, under Subsection 46.2(k)(4), lenders will have the burden of proving fraud in any administrative action brought by the Department under this provision. Furthermore, nothing in this section shall relieve or be construed to relieve any lender from any other liability to borrowers from failing to fund loans that have closed and are not rescinded by the borrower, regardless of whether there is a claim of fraud. See Section 46.2(k)(5).

93. **Comment.** One commentator has expressed concern over the provision because federal law allows for extended rescission periods, such as if there were errors in earlier disclosures and, therefore, the time for funding could be extended. (12)

**Response.** The timing of the rescission period, and whether it is extended and provides a lender with additional time to fund, is controlled by the provisions of federal law referenced by the regulation. To the extent that 12 CFR 226.15 or 226.23 provides for such extended rescission periods, such extensions would be applicable under the regulation. The Department notes however, that the responsibility for correct preparation of disclosures and documents is on the licensee lender and its agent and the responsibility for curing any issues regarding incorrect disclosure or documents falls on those parties and should not be used as an excuse for inconveniencing the borrower.

94. **Comment.** A commentator has requested that the language "through a licensee's action or inaction a lender may not refuse to fund" be added to this provision. (3)

**Response.** The Department does not fully understand the reasoning provided by the commentator for the inclusion of this language. The commentator sets forth a scenario where a loan is ready to close but because of a bankruptcy, the company stops funding the loan. The commentator further states that in such situations, the applicant is better off with a licensee that is able to move the loan to another lender. The Department agrees that when a lender enters bankruptcy and fails to fund loans, the applicant's loan should be moved to another lender as soon as possible. Generally, when this happens, the bankrupt lender works with the Department

to make sure that such transfers occur. However, because of the restrictions a bankrupt company operates under, such transfers are dependant upon the specific facts and circumstances of the particular bankruptcy and the type of bankruptcy filed. Therefore, the Department has concerns with inserting language in the regulation that may conflict with federal bankruptcy law or interfere with the rights of the bankrupt company.

Section 46.2(h)  
[Final-Form § 46.2(l)]

95. **Comment.** One commentator has requested that the language of this provision be changed to require production of documents to applicants upon the request of the applicant and to the extent that the licensee has the documents in its possession. (39)

**Response.** The Department agrees with this request and has revised the language of this subsection accordingly in the Final-Form Regulation.

Section 46.2(i)  
[Final-Form § 46.2(i)(m)]

96. **Comment.** One commentator has suggested that this provision should only cover servicers or lenders who hold their own loans. (12)

**Response.** The Department recognizes that licensees may sell or otherwise transfer loans that they have either funded or originated and would not be able to comply with this provision because under such circumstances they would not have in their possession sufficient information or documents to base a reply. Therefore, the Department agrees with this comment and has revised the provision to only cover licensees that hold or service loans. Licensees that service loans would also have sufficient information available to ensure compliance with the provision.

Miscellaneous Comments

97. **Comment and Response.** The comment provided by commentator No. 5 contains no commentary regarding the proposed regulation or any of the provisions therein and the Department generally does not understand the purpose of the comment. Therefore, the Department is unable to respond.

**Department of Banking  
Commentator Address List  
Regulation 3043**

- A. The following commentators requested notice of the Department's submission of the final-form regulation:
1. Herbert H. Braden  
Carteret Mortgage Corporation  
376 Laurelwood Drive  
Lebanon, PA 17042
  2. Robert Dougherty, Sr.  
1612 Clay Avenue  
Dunmore, PA 18509
  3. Mr. Robert Dunn  
415 Monterey Lane  
West Chester, PA 19380
  4. Art Karbowski  
WF&K Mortgage, Inc.  
718 E. Drinke Street  
Dunmore, PA 18512
  5. John Mataboni  
15 Country Road  
Northampton, PA 18067
  6. John Topa  
First Sunrise Mortgage  
124 S Blakely Street  
Dunmore, PA 18512
  7. Mark Warshal  
Fairway Consumer Discount Co.  
8 Marion Street P.O. Box 12  
Luzerne, PA 18709

- B. The Department has also provided notice of the submission of the final-form regulation to the following parties:
1. Kerry E. Smith, Esquire  
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3638 North Broad Street  
Philadelphia, PA 19140
  2. Ian Phillips  
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  3. Alan L. Jennings  
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Community Action Committee  
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  4. Brady Russell  
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  5. David B. Ward  
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  6. Gabriel D Alessi, Vice President  
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York, PA 17402
11. Frank A. Pinto, President/CEO  
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12. Cynthia Witman Daley  
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14. E. Robert E. Levy  
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15. Frank Bowersox, President  
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16. E. Robert E. Levy  
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Woodbridge, N.J. 07095

**TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE  
REGULATORY REVIEW ACT**

**I.D. NUMBER**      3-43

**SUBJECT:**            **PROPER CONDUCT OF LENDING AND BROKERING IN THE MORTGAGE  
LOAN BUSINESS**

**AGENCY:**            **DEPARTMENT OF BANKING**

**TYPE OF REGULATION**

- Proposed Regulation
- Final Regulation
- Final Regulation with Notice of Proposed Rulemaking Omitted
- 120-day Emergency Certification of the Attorney General
- 120-day Emergency Certification of the Governor
- Delivery of Tolled Regulation
  - a.                      With Revisions                      b.                      Without Revisions

INDEPENDENT REGULATORY  
REVIEW COMMISSION

2008 SEP 25 PM 2:44

RECEIVED

**FILING OF REGULATION**

| DATE    | SIGNATURE                                    | DESIGNATION   |
|---------|--|---|
| 9/18/08 | <i>Sandy Attland<br/>for Rep Peter Daley</i> | HOUSE COMMERCE COMMITTEE  |
| 9/25/08 | <i>Barbara Ramsey<br/>for Rep Dick Bless</i> | MAJORITY CHAIRMAN<br>THE HONORABLE PETER J. DALEY   |
| 9/25/08 | <i>Macki Powers for<br/>Don White</i>        | SENATE COMMITTEE ON BANKING & INSURANCE<br><br>MAJORITY CHAIRMAN<br>THE HONORABLE DONALD C. WHITE |
| 9/25/08 | <i>Diana Hull<br/>for Senator Mike Jack</i>  | <del>INDEPENDENT REGULATORY REVIEW COMMISSION</del>   |
| 9/25/08 | <i>J. Bennett</i>                            | INDEPENDENT REGULATORY REVIEW COMMISSION<br>ATTORNEY GENERAL (for Final Omitted only)             |
|         |  | LEGISLATIVE REFERENCE BUREAU (for Proposed only)  |