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A TAXONOMIC ANALYSIS OF MORTGAGE BROKER LICENSING STATUTES: DEVELOPING A PROGRAMMATIC RESPONSE TO PREDATORY LENDING

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INTRODUCTION

This Article focuses on regulating mortgage brokers as one means to combat predatory mortgage lending. There are at least three justifications for targeting mortgage brokers for regulation: (1) mortgage brokers generate a majority of loans secured by a mortgage on residential real estate;¹ (2) mortgage brokers are often the borrower's point of introduction to mortgage-based financing and generally have more direct contact with the borrower than any other participant in the lending process;² and (3) mortgage brokers are significant participants in predatory lending, as evidenced by state mortgage broker licensing statutes that expressly identify the need to "help consumers avoid being victimized by unscrupulous...mortgage brokers"³ and the need to "provide for the protection of the borrowing public."⁴ Regulating mortgage broker conduct can thus protect consumers by directing attention to a party who plays a pivotal role, both quantitatively and qualitatively, in the predatory lending process.⁵

This Article uses a taxonomic approach to analyze state statutes that license and regulate mortgage brokers.⁶ In a taxonomy, objects are first grouped into categories based on common traits. The various categories are then arranged into a hierarchy, usually based on differences in complexity or sophistication with regard to a chosen

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1. See *Licensing and Registration in the Mortgage Industry: Hearing Before the H. Subcomm. on Housing and Community Opportunity of the Comm. on Fin. Servs.*, 109th Cong. 18, 70 (2005) [hereinafter *Licensing and Registration Hearing*] (statement of Joseph L. Falk, President, Irian Mortgage Servs., on behalf of the Nat'l Ass'n of Mortgage Brokers) (asserting that the members of the National Association of Mortgage Brokers account for "almost 70% of the marketplace" and that "mortgage broker operations across the nation...originate 65% of all residential loans in the U.S.").

2. See *id.* at 25, 44 (testimony and statement of Teresa Bryce, Senior Vice President and Director of Legal and Corporate Affairs, Nextar Financial Corporation, on behalf of the Mortgage Bankers Ass'n).

3. MINN. STAT. ANN. § 58.10, subd. 3 (West 2002).

4. N.C. GEN. STAT. § 53-243.04 (1999).

5. For a more extensive discussion of mortgage brokers' quantitative involvement in real estate based loans and their qualitative impact on borrowers, see generally Lloyd T. Wilson, Jr., *Effecting Responsibility in the Mortgage Broker-Borrower Relationship: A Role for Agency Principles in Predatory Lending Regulation*, 73 U. CIN. L. REV. 1471 (2005). The *Effecting Responsibility* article makes a case for an agency regime for mortgage brokers on two grounds: (1) an agency regime can be extrapolated from the trajectory of high-cost loan regulation and (2) a borrower's agency regime for mortgage brokers is supported by analogy to the creation of a buyer's agency regime that arose following the abandonment of mandatory sub-agency in real estate sales brokering. The present Article builds on the *Effecting Responsibility* article, and some references in the present Article are more fully explained in the prior one.

6. For a more thorough explanation of the process and benefits of a taxonomic approach, see TAXONOMY OF EDUCATIONAL OBJECTIVES: THE CLASSIFICATION OF EDUCATIONAL GOALS, HANDBOOK 1: COGNITIVE DOMAIN 10-11, 17-24 (Benjamin S. Bloom ed., David McKay Co. 1974) (1956).

organizing principle. The organizing principle provides the norm and criterion for deciding where items are to be located within the hierarchy. Analyzing mortgage broker statutes taxonomically produces two benefits. First, the taxonomy provides a common typological language, which permits statutes that vary in organization and content to be compared and to be mutually informative. Second, the hierarchical arrangement of categories within the taxonomic framework provides a principled basis for concluding that one statute is better or worse than another because it is a more or less sophisticated expression of the taxonomy's organizing principle.

The organizing principle selected for the taxonomy constructed in this Article is the prevention of predatory acts by mortgage brokers. In the taxonomic categories established below, a licensing statute that provides more consumer protection—whether by expanding the scope of persons subject to regulation, by expanding the types of documents a broker must retain and preserve, or by providing additional remedies for consumers—is ranked higher on the taxonomic scale than a statute that provides fewer of these protections or provides them in a restricted form.

The consumer protection criterion has three pragmatic benefits. First, it provides a basis for suggesting improvements within each taxonomic category.⁷ Second, it provides a basis for encouraging upward movement among the categories. Third, the criterion can be used to suggest innovations that are hinted at in some licensing statutes but are not fully expressed or developed. For example, some licensing statutes impose duties on a mortgage broker in favor of the borrower-consumer as an inherent part of their relationship.⁸ The nature and scope of those duties vary considerably, however, and often appear inadequate to accomplish the state's intended goal. The taxonomic hierarchy provides both a method for concluding that such statutes are incomplete attempts to restructure the mortgage broker-borrower relationship and a basis for advocating a statutory regime of agency duties for mortgage brokers.

To evaluate the effectiveness of mortgage broker licensing statutes as a tool for combating predatory lending, this Article examines the statutes of four states: Vermont, Kentucky, Minnesota, and North Carolina.⁹ These statutes were chosen as representatives of different models that states use to regulate mortgage broker activities and to define the relationship between mortgage brokers and borrower-consumers. These statutes were not chosen because they are free of flaws. Instead, each was chosen because it represents a different response to a common realization—that consumers will not be protected from predatory acts by mortgage brokers without reorienting the broker-borrower relationship to remove the

7. See *id.* at 17 (“We need a method of ordering phenomena such that the method of ordering reveals significant relationships among the phenomena. This is the basic problem of a taxonomy—to order phenomena in ways which will reveal some of their essential properties as well as the interrelationships among them.”).

8. See, e.g., N.C. GEN. STAT. ANN. § 53-243.10 (West, Westlaw through 2005 Reg. Sess.).

9. This Article does not attempt to achieve geographic distribution with the selected states, nor does it seek to account for all fifty states. Instead, these four states were chosen because their statutes evidenced different models for orienting the mortgage broker-borrower relationship. In the end, Vermont, Kentucky, Minnesota, and North Carolina were chosen, instead of other representatives of the same models, because the provisions of their licensing statutes are instructive. For an article that engages in a somewhat similar analysis, see Laurence Hansen, Note, *Brokers We Trust—Mortgage Licensing Statutes Address Predatory Lending*, 14 J. AFFORDABLE HOUSING & CMTY. DEV. L. 332 (2005).

opportunity and incentive for mortgage brokers to exploit information and power asymmetries. I contend that these models point toward a statutory agency regime as the most effective relationship model.¹⁰

The intended result of this evaluation of licensing statutes is a programmatic regulation of mortgage brokers that will combat predatory lending. This programmatic regulation can be combined with other programmatic responses, including those that (1) directly prohibit specific terms and practices, (2) target other actors in the predatory lending “pipeline” (such as lenders and real estate appraisers), (3) address support systems that enable predatory brokers and lenders to stay in business (such as secondary market investors who provide the capital used to fund predatory loans and the holder in due course doctrine that can insulate investors from liability for the predatory acts of loan originators), and (4) address other manifestations of predatory lending (such as payday loans and home improvement scams).¹¹ The goal of this Article is not to displace these other anti-predatory lending proposals; rather, the goal is to contribute a programmatic scheme that can be used in conjunction with other programmatic schemes to form a systematic response to predatory lending.

This Article classifies mortgage broker licensing statutes into three major categories. Identified in increasing order of sophistication according to the taxonomic criterion, these categories are (1) the gatekeeper function,¹² (2) the administrative oversight function,¹³ and (3) the relationship defining function.¹⁴ Within each of these categories, licensing statutes contain multiple components that can be grouped into sub-categories and ordered. The variations found among comparable sub-categories produce meaningful suggestions for improving mortgage broker regulation based on existing best practices.

Following the Introduction, this Article examines each of the three major categories. Part I examines the gatekeeper function of licensing statutes, especially with regard to their effectiveness at precluding persons who pose a threat of predatory behavior from gaining access to consumers. Part II examines the administrative oversight function of licensing statutes, with the goal of identifying those practices that best enable the state to police brokers once they obtain a license and best compensate consumers for damages caused by a broker’s predatory acts. Part III examines provisions of licensing statutes that attempt to define the nature of the broker-borrower relationship. Based on a trajectory that I believe can be constructed from the taxonomic ordering, I argue that mortgage brokers should be subject to statutory agency duties, much like the statutory agency duties applied to real estate sales brokers in many states following the abrogation of mandatory sub-agency in the mid- to late-1990s.¹⁵ A statutory agency regime, I contend, would be the capstone of this third category within the taxonomic hierarchy.

10. This Article thus reinforces the trajectory noted in Wilson, *supra* note 5, at 1519–23.

11. For a discussion of the variety of programmatic responses to predatory lending, see *id.* at 1472 n.3.

12. See *infra* Part I.

13. See *infra* Part II.

14. See *infra* Part III.

15. See Wilson, *supra* note 5, at 1503–19.

Agency duties for mortgage brokers are currently not the norm. Instead, in states that make any attempt to define the nature of the broker-borrower relationship, three alternative models prevail. One model creates some duties for mortgage brokers as a matter of state-prescribed contract.¹⁶ A second model creates selected agency duties, but only if the mortgage broker engages in specified acts or affirmatively chooses to act as the borrower's agent. In the absence of such acts or assent, a broker is free to disavow duties to a borrower.¹⁷ A third model creates mandatory agency-like duties but does not specifically, or comprehensively, establish an agency regime.¹⁸ This Article describes these models within the relationship defining category as (1) the contractual duty model, (2) the optional quasi-agency duty model, and (3) the mandatory quasi-agency duty model. Judged by the taxonomic criterion of consumer protection, each of these models is more effective than the preceding one. By the same standard, one can also conclude that the quasi-agency model would be superseded by an express and fully developed statutory agency regime. However, before discussing the creation of a new relationship model, the Article must take up the preceding taxonomic categories.

I. THE GATEKEEPER FUNCTION

The most common means of regulating mortgage brokers is to require a broker to obtain a license as a prerequisite to engaging in business. The license requirement enables the state to serve as gatekeeper to the industry, issuing a license only to those persons who exhibit desirable traits and possess relevant knowledge and denying a license to persons who appear to pose a risk of engaging in predatory behavior or other practices harmful to the borrowing public. The gatekeeping function occupies the initial position in the taxonomy proposed in this Article because regulation does not extend beyond the initial license application. While the gatekeeper function precedes the administrative oversight and relationship defining functions chronologically, it is the organizing principle of consumer protection that really accounts for its place at the base of the taxonomic hierarchy.

The gatekeeper function is carried out through the license application and approval process. Components of this process include (1) defining the scope of the license requirement,¹⁹ (2) verifying the personal character and business background

16. The representative of this model is Vermont's Licensed Lenders Act. VT. STAT. ANN. tit. 8, §§ 2200–2239 (2001 & Supp. 2005).

17. The representatives of this model are Kentucky's Mortgage Loan Company and Mortgage Loan Broker Act, KY. REV. STAT. ANN. §§ 294.010–990 (West 2001 & Supp. 2005), and Minnesota's Residential Mortgage Originator and Servicer Licensing Act, MINN. STAT. ANN. §§ 58.01–17 (West 2002 & Supp. 2006). Even though both statutes follow the same model, the differences between them are significant enough that both are discussed in this Article. These statutes demonstrate that variations occur within a single taxonomic category as well as between different categories. It must also be noted that Kentucky's Mortgage Loan Company and Mortgage Loan Broker Act appears technically to include only sections 294.010 to .230. There are six additional sections, clearly relating to mortgage broker licensing, found at sections 294.250 to .990. In this Article, references to the Kentucky Mortgage Loan Company and Mortgage Loan Broker Act include those six additional sections.

18. The representative of this model is North Carolina's Mortgage Lending Act. N.C. GEN. STAT. §§ 53-243.01–16 (West, Westlaw through 2005 Reg. Sess.).

19. See, e.g., KY. REV. STAT. ANN. § 294.020 (West Supp. 2005); MINN. STAT. ANN. § 58.04, subdiv. 1 (West 2002); N.C. GEN. STAT. § 53-243.01(8); VT. STAT. ANN. tit. 8, § 2201 (2001).

of the applicant,²⁰ (3) ensuring the financial responsibility of the applicant,²¹ (4) ensuring the technical competency of the applicant,²² (5) defining the criteria for approving or denying the application,²³ and (6) dedicating a portion of application fees to consumer education.²⁴

A. Scope of the License Requirement

A state can discharge its gatekeeping function effectively only if the scope of the licensing statute is broad enough to capture all applicants who pose an appreciable threat to consumers.²⁵ In this regard, licensing statutes typically contain a section that defines who is subject to, and who is exempt from, regulation. The term “mortgage broker” is usually defined by identifying the activities common to that occupation. For example, in Kentucky’s Mortgage Loan Company and Mortgage Loan Broker Act, the term mortgage loan broker means:

any person who for compensation or gain, or in the expectation of compensation or gain, directly or indirectly:

(a) Holds himself out as being able to serve as an agent for any person in an attempt to obtain a loan which will be secured by a mortgage on residential real property....²⁶

North Carolina’s Mortgage Lending Act is more comprehensive. It defines a mortgage broker as one who:

act[s], for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly, by accepting or offering to accept an application for a mortgage loan, soliciting or offering to solicit a mortgage loan, negotiating the terms or conditions of a mortgage loan, issuing mortgage loan commitments or interest rate guarantee agreements to borrowers, or engaging in tablefunding of mortgage loans, whether such acts are done through contact by telephone, by electronic means, by mail, or in person with the borrowers or potential borrowers.²⁷

In addition to functional concerns, jurisdictional and territorial issues also figure into the scope of some licensing statutes. Minnesota’s Residential Mortgage

20. See, e.g., KY. REV. STAT. ANN. § 294.080; MINN. STAT. ANN. § 58.06, subdiv. 2; N.C. GEN. STAT. § 53-243.05(a)(4), (6); VT. STAT. ANN. tit. 8, § 2202 (Supp. 2005).

21. See, e.g., KY. REV. STAT. ANN. § 294.032; MINN. STAT. ANN. §§ 58.06, subdiv. 2(a)(4), 58.08; N.C. GEN. STAT. § 53-243.05(a)(5); VT. STAT. ANN. tit. 8, § 2203.

22. See, e.g., KY. REV. STAT. ANN. § 294.032(6); N.C. GEN. STAT. § 53-243.05(c)(1), (1a).

23. See, e.g., KY. REV. STAT. ANN. § 294.080; MINN. STAT. ANN. § 58.12, subdiv. 1; N.C. GEN. STAT. § 53-243.05(i); VT. STAT. ANN. tit. 8, § 2204(a).

24. See, e.g., MINN. STAT. ANN. § 58.10, subdiv. 1.

25. The issue of who should be subject to licensure was debated in a congressional subcommittee hearing on September 29, 2005. In that hearing, Joseph L. Falk, testifying on behalf of the National Association of Mortgage Brokers, argued that if individual mortgage brokers are compelled to register under a proposed federal law, then employees of mortgage bankers should also be made subject to individual level registration. *Licensing and Registration Hearing*, *supra* note 1, at 8–9, 21, 52. At the same hearing, Teresa A. Bryce, testifying on behalf of the National Association of Mortgage Bankers, argued that individual level registration was indeed appropriate for mortgage brokers but only institutional level registration should be required for mortgage bankers. *Id.* at 6–8, 44.

26. KY. REV. STAT. ANN. § 294.010(8).

27. N.C. GEN. STAT. ANN. § 53-243.01(1).

Originator and Servicer Licensing Act, for example, addresses out-of-state activities: "This chapter applies when an offer of residential origination services is made to a borrower in this state or when the residential mortgage originator is located in this state."²⁸ Some states also require out-of-state brokers to maintain a physical location within the state,²⁹ a requirement likely to be challenged by the financial services industry.³⁰

State licensing statutes also provide that some persons who provide mortgage financing services can be safely excluded from the gatekeeping process. A mortgage broker's license is not required if a person (1) is engaged in a business activity, such as banking or insurance, that is subject to other governmental oversight;³¹ (2) is engaged in a profession, such as law or real estate sales, that is subject to other licensing requirements and to professional standards established by a self-regulating organization;³² (3) is an individual who loans his or her own funds as an investment with no intent to resell the loans;³³ (4) is engaged in providing seller financing in connection with the sale of one's own land;³⁴ (5) is acting as a representative of a non-profit organization;³⁵ or (6) is engaged in commercial lending.³⁶

Evaluated by the taxonomic norm of effecting consumer protection, the sweep of licensing statutes should be wide. States should broadly define those persons subject to regulation and narrowly define those persons who are exempted. For those persons subject to regulation, requiring a physical presence within the state as a condition of licensing can help ensure that licensees are accountable to the state and to consumers who reside there. If a physical presence requirement is found to be invalid, licensees should nevertheless be required to designate an in-state agent for service of process and to maintain sufficient assets within the state to satisfy judgments entered in favor of consumers. Victims of predatory lending, who already face significant obstacles to obtaining compensation, should not be compelled to pursue predators and their assets around the country.

B. Personal Character and Business Background Disclosure and Verification

Once the scope of the licensing statute has been determined, a state must establish procedures for determining which applicants should receive licenses and which applicants should be precluded from gaining access to the borrowing public. This decision depends on verifying the personal character and business background

28. MINN. STAT. ANN. § 58.17, subdiv. 1.

29. See, e.g., KY. REV. STAT. ANN. § 294.250(2)(a).

30. See *Licensing and Registration Hearing*, *supra* note 1, at 46 (testimony of Teresa Bryce) (testifying that the requirement of an in-state presence "is likely a violation of the Interstate Commerce Clause of the United States Constitution").

31. See, e.g., N.C. GEN. STAT. ANN. § 53-243.01(8)(c).

32. See, e.g., KY. REV. STAT. ANN. § 294.020(1)(b); N.C. GEN. STAT. ANN. § 53-243.01(8)(d).

33. See, e.g., N.C. GEN. STAT. ANN. § 53-243.01(8)(f).

34. See, e.g., KY. REV. STAT. ANN. § 294.020(2)(b).

35. See, e.g., VT. STAT. ANN. tit. 8, § 2201(c)(11) (2001).

36. This list of excluded persons is gleaned from KY. REV. STAT. ANN. § 294.020, MINN. STAT. ANN., § 58.04, subdiv. 1(b)(1)–(10) (West 2002), N.C. GEN. STAT. ANN. § 53-243.01(8)(a)–(i), and VT. STAT. ANN. tit. 8, § 2201(c)(1)–(11).

of the applicant. Verification consists of two phases: (1) self-disclosure by the applicant³⁷ and (2) investigation by the relevant state regulatory agency.³⁸

Self-disclosure occurs in response to questions included on an application form, the contents of which are mandated by statute and administrative regulation.³⁹ Self-disclosure begins with identifying the applicant and the applicant's form of business. When an applicant intends to conduct business as a corporation, limited liability company, limited partnership, or other non-natural entity, the identification process expands to include all shareholders, directors, officers (or similarly situated persons in the other business forms), and the person responsible for daily operations at each location operated by the applicant.⁴⁰ If the applicant has one or more related entities, such as a parent company or one or more subsidiaries or divisions, each of those entities must also be identified, along with its shareholders, directors, and officers (or similarly situated persons in other business forms).⁴¹

Each person identified on the application should be required to disclose his or her involvement with regulatory, criminal, civil, or bankruptcy proceedings.⁴² Regulatory history should include information about other license applications or registrations and any administrative investigations, orders, or sanctions. Some states limit disclosure to events relating to mortgage financing.⁴³ Other states consider all regulatory history to be relevant, without regard to specific context.⁴⁴ Regulatory activity by any agency of the federal government should also be included, as is the practice in some states.⁴⁵

The criminal history disclosure requirement should include all felony convictions or plea agreements and all misdemeanor convictions or plea agreements involving

37. See, e.g., N.C. GEN. STAT. ANN. § 53-243.05(i); 4 N.C. ADMIN. CODE 3M.0201 (2003); see also, e.g., North Carolina Mortgage Broker Lender or Broker Application, Form MLA001, available at <http://www.nccob.org/NCCOB/Mortgage/FormsFees/> (follow "MLA001" hyperlink) (last visited Apr. 17, 2006) [hereinafter North Carolina Application].

38. See, e.g., N.C. GEN. STAT. ANN. § 53-243.05(a)(5)-(6).

39. See, e.g., KY. REV. STAT. ANN. § 294.032; MINN. STAT. ANN. § 58.06, subd. 1; N.C. GEN. STAT. ANN. § 53-243.05(a); VT. STAT. ANN. tit. 8, § 2202(a) (Supp. 2005).

40. For examples of mortgage broker application forms, which often include multiple attachments, see Commonwealth of Kentucky, Office of Fin. Insts., Downloadable Forms, <http://www.kfi.ky.gov/downloadableforms> (follow hyperlinks under "Mortgage Application/Forms") (last visited Apr. 17, 2006); North Carolina Application, *supra* note 37; State of Vermont Application for Lender, Mortgage Broker and/or Sales Finance Company Licenses, available at http://www.bishca.state.vt.us/BankingDiv/lenderapplic/Application_effJul1_05.pdf (last visited Apr. 17, 2006) [hereinafter Vermont Application].

41. See, e.g., Vermont Application, *supra* note 40, q. 9, at 2. The question asks: "Does the applicant have any parent companies, subsidiaries, or affiliates?" If the answer is "yes," the applicant must "submit a list of all affiliates of the applicant, including full exact name(s) of parent companies and subsidiaries, and their principal lines of business" and "submit a chart which diagrams all parent/subsidiary relationships and ownership percentage of all affiliates."

42. See North Carolina Application, *supra* note 37, q. 11, at 4; Vermont Application, *supra* note 40, qq. 17-25, at 4.

43. See, e.g., KY. REV. STAT. ANN. § 294.090(6)-(7).

44. See, e.g., Vermont Application, *supra* note 40, qq. 19-24, 30, at 4-5.

45. See, e.g., *id.* qq. 19-20, at 4; North Carolina Application, *supra* note 37, sched. D-1, q. 2(g).

mortgage financing specifically⁴⁶ and fraud or deception in general.⁴⁷ Applicants may also be required to disclose all convictions for any crime committed anywhere,⁴⁸ judgments that involve “moral turpitude,”⁴⁹ the existence of any past or current injunction or restraining order, any pending civil actions, and any prior and pending bankruptcy petitions.⁵⁰

The goal of these disclosure requirements is to identify those persons who appear to pose a threat to the borrowing public. States have recognized that accomplishing this goal depends on acquiring adequate and relevant background information about each applicant and about each participant in the applicant’s mortgage brokering business. To the extent that state licensing statutes differ, it is in degree rather than in principle. One state may require disclosure of events reaching back a specified period, five or ten years for example,⁵¹ while another state may have an open-ended reporting requirement.⁵² As a general matter and when judged by the taxonomic criterion of consumer protection, the most effective licensing statute is one that seeks the greatest amount of information over the longest period of time for each person who will have contact with borrowers.

There is one aspect of the disclosure requirement of licensing statutes that merits more detailed discussion—identifying persons who are not officers, directors, or managers, but who will nevertheless have the capacity to direct or influence the applicant’s business activities. The concept of “control” is frequently addressed in the definitional section of licensing statutes.⁵³ Vermont’s Licensed Lender Law, which is representative, provides that “control” means:

the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or

46. Vermont Application, *supra* note 40, q. 21, at 4 (“Has the applicant, any of its affiliates, senior officers, directors, principal shareholders/partners, or beneficiaries (of a trust) been enjoined or restrained by order of any court from engaging in any conduct or practice relating to the arranging or extension of credit?”).

47. MINN. STAT. ANN. § 58.12, subdiv. (1)(b)(2)(iv) (West 2002) (providing that the commissioner of commerce may take action if the applicant “violated a standard of conduct or engaged in a fraudulent, coercive, deceptive, or dishonest act or practice, whether or not the act or practice involves the residential mortgage lending business”); N.C. GEN. STAT. ANN. § 53-243.05(a)(4) (West, Westlaw through 2005 Reg. Sess.); North Carolina Application, *supra* note 37, q. 11(g), at 4.

48. Minnesota requires disclosure of information about all criminal convictions, “excepting traffic violations.” MINN. STAT. ANN. § 58.12, subdiv. 2(c).

49. North Carolina Application, *supra* note 37, sched. D-1, q. 2(d) (“Moral turpitude involves duties owed by persons to society as well as acts contrary to justice, honesty, principle, or good morals. It includes, but is not limited to, theft, extortion, obtaining property under false pretenses, tax evasion, and the sale of (or intent to sell) controlled substances.”) (emphasis omitted).

50. Vermont Application, *supra* note 40, qq. 19–24, 30, at 4–5.

51. North Carolina’s statute dealing with the commissioner’s power to discipline brokers is open-ended with regard to “any felony,” but limits reporting of conviction of “any misdemeanor involving mortgage lending or any aspect of the mortgage lending business, or any offense involving breach of trust, moral turpitude, or fraudulent or dishonest dealing” to the prior ten years. N.C. GEN. STAT. ANN. § 53-243.12(a)(2)(c). North Carolina only requires reporting of orders “by the authority of any state with jurisdiction over that state’s mortgage brokerage...industry denying or revoking that person’s license as a mortgage broker” that occurred within the prior five years. *Id.* § 53-243.12(a)(2)(f).

52. See, e.g., Vermont Application, *supra* note 40, qq. 19–23, at 4.

53. See MINN. GEN. STAT. ANN. § 58.02, subdiv. 17 (West Supp. 2006); N.C. GEN. STAT. ANN. § 53-243.01(6); VT. STAT. ANN. tit. 8, § 2200(4) (2001); 808 KY. ADMIN. REGS. 12:002 (2006).

nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person.⁵⁴

Licensing statutes differ with regard to the percentage of ownership interest that presumptively vests a person with controlling power. The lowest percentage among states that specifically address the issue is ten percent, as in Vermont.⁵⁵ North Carolina sets a higher threshold by defining control as the "power to vote more than twenty percent (20%) of outstanding voting shares or other interests of a corporation, partnership, limited liability company, association, or trust."⁵⁶ Kentucky's administrative regulations place the threshold at twenty-five percent.⁵⁷

Disclosing the identity of persons who wield control is important to the gatekeeping function. Without this requirement, a person with a negative reportable event in his or her background can avoid disclosure by refraining from serving as an officer or director, but could still direct the applicant's mortgage brokerage business through the control that follows from ownership. Statutory definitions of control should prefer a lower ownership percentage threshold over a higher one.

The second phase of the application process is to verify the applicant's self-disclosed information. Disclosure of personal and business background information is a necessary component of the gatekeeping function but is not, by itself, sufficient to protect the public. Self-disclosure by an applicant, especially one who has something to hide, risks incomplete, inadequate, or blatantly false statements. Independent verification is essential if predatory brokers are to be kept away from consumers. Accordingly, licensing statutes grant to a designated regulatory agency the power to investigate the applicant and information provided on the application form.⁵⁸ To carry out this investigation, the application documents should include (1) the applicant's consent to a state criminal background check⁵⁹ and to a federal criminal background check,⁶⁰ (2) a waiver of confidentiality and privacy rights,⁶¹ and (3) consent to a credit history check.⁶²

If the public is to be protected, the verification process must be meaningful. State regulators may have the authority to investigate license applicants, but the large number of mortgage broker applications and the realities of budgetary constraints facing state governments threaten the thoroughness of the background investigation. The Office of the Commissioner of Banks (OCOB) in North Carolina reports that in the fiscal year ending on June 30, 2004, which was the first year that included applications both for new licenses and for renewals of existing licenses, OCOB staff

54. VT. STAT. ANN. tit. 8, § 2200(4).

55. *Id.*

56. N.C. GEN. STAT. ANN. § 53-243.01(6).

57. 808 KY. ADMIN. REGS. 12:002. The Kentucky statute defines "change of control" as a "transfer of at least ten percent (10%) of the outstanding voting stock of a mortgage loan company or mortgage loan broker." KY. REV. STAT. ANN. § 294.075(1)(b) (West Supp. 2005). The discrepancy is not explained.

58. *See, e.g.*, KY. REV. STAT. ANN. § 294.140(2)-(3); VT. STAT. ANN. tit. 8, § 2222(1).

59. *See* N.C. GEN. STAT. ANN. § 53-243.16.

60. *See* 808 KY. ADMIN. REGS. 12:085.

61. *See* Kentucky Privacy Act Waiver, available at <http://www.kfi.ky.gov/downloadableforms/> (follow "Privacy Act Waiver" hyperlink) (last visited Apr. 17, 2006).

62. *See* North Carolina Application, *supra* note 37, at 5 (authorizing the commissioner to "conduct a financial and business responsibility background check").

processed 775 mortgage broker applications. In addition, the OCOB staff processed 625 mortgage lender applications and 13,025 loan officer applications.⁶³ Given the burden imposed by numbers of this size, there is a risk that license applications might be approved perfunctorily, thereby thwarting the gatekeeping function.

One way to help prevent budgetary constraints from frustrating the investigative process is to pass the cost of the investigation to the applicant. All states impose a license application fee, but the amounts vary widely. Vermont, for example, imposes a flat “application and investigation fee” of \$350.⁶⁴ The application fee in North Carolina is \$1,000 plus “the actual cost of obtaining credit reports and State and national criminal history record checks.”⁶⁵ The fees charged to applicants for mortgage broker licenses should not be so large as to preclude people from entering the occupation, but neither should the fee be so small that a state is not able to perform its gatekeeping role because there are insufficient resources to investigate and verify the information provided by each applicant. The state regulator must have the resources to discharge the legislative mandate to conduct a meaningful personal history and business background check.

States should also not place any artificial limitations on the time in which the regulating body must complete its investigation. In Vermont, the Commissioner of Banking, Insurance, Securities, and Health Care Administration is compelled by statute to approve or deny an application within sixty days.⁶⁶ If the application is going to be denied, the commissioner must “stat[e] the reason or reasons therefore.”⁶⁷ On the other hand, if the application is approved, the Commissioner is certifying that “allowing the applicant to engage in business will promote the convenience and advantage of the community”⁶⁸ and that the applicant possesses the “financial responsibility, experience, character, and general fitness...such as to command the confidence of the community and to warrant belief that the business will be operated honestly, fairly, and efficiently.”⁶⁹ Given the choice between specifically stating reasons for denial and implicitly certifying the applicant’s character, the risk is that the latter option will be chosen simply to meet the statutory deadline. Investigations must be conducted within a reasonable time to avoid denial of due process claims, but a “drop dead” date of sixty days could prove unnecessarily restrictive, especially if staffing limitations mean the investigative process has not yet been completed.

Licensing statutes in some states impose no specific deadline on the regulatory body to rule on an application. Instead, the implementing regulations speak only to the expected time needed to obtain criminal history and credit reports, and even that

63. Letter from Joseph A. Smith, Jr., Commissioner of Banks, to Governor Michael Easley (Sept. 9, 2004), available at http://www.nccob.org/NR/rdonlyres/9210EF03-99BD-41A2-A90F-371962FDA2F8/0/ReporttoGovernor_2004.pdf.

64. VT. STAT. ANN. tit. 8, § 2202(b)(2) (Supp. 2005).

65. N.C. GEN. STAT. ANN. § 53-243.05(e) (West, Westlaw through 2005 Reg. Sess.).

66. VT. STAT. ANN. tit. 8, § 2204(c) (2001).

67. *Id.* tit. 8, § 2204(b).

68. *Id.* tit. 8, § 2204(a)(2).

69. *Id.* tit. 8, § 2204(a)(1).

expectation is qualified.⁷⁰ The criterion of consumer protection is better served by states that allow the regulating body a sufficient amount of time to carry out the task assigned by the legislature.

C. Assurance of Financial Responsibility

Another aspect of the license application process that benefits consumers is the requirement that the applicant post a surety bond. The bond is required “to secure the faithful performance of the obligations of the licensee” imposed by the licensing act⁷¹ and to provide some measure of accountability to consumers. The form of the bond is dictated by statute or regulation and often provides that the principal and surety “are held and firmly bound unto the Commissioner. . . for the use and benefit of claimants against the Principal.”⁷²

While the bond requirement could be said to be principally involved with the oversight function, which is described in Part II below, it also serves a gatekeeping function by weeding out those applicants who are not willing to expose at least some of their own capital (in the form of the bond premium) to consumer claims. The principal difference among the state licensing statutes is the face amount of the bond. Bond amounts range from \$25,000⁷³ to \$50,000.⁷⁴

The face amount of the bond required of mortgage broker license applicants is, to phrase the matter charitably, inadequate. If a mortgage broker obtains a license and then engages in predatory activities, the bond could be exhausted by a single claimant, leaving the broker’s other victims without any source of recovery. States should significantly increase the required bond amount. Increasing the amount of the bond will have at least two positive ramifications. First, it will provide a meaningful source of recovery for victims of predatory acts by mortgage brokers. Second, increasing a bonding company’s financial exposure will likely result in more careful background checks of the applicant by that company. Although the state should not consider a bonding company’s investigation to be a reason to abdicate its own investigative responsibility, the private sector can supplement a state’s efforts to discover and exclude undesirable applicants.

Another way states can improve the financial accountability component of their mortgage broker licensing statutes is to impose an asset requirement in addition to the surety bond. Many states impose a liquid assets requirement on mortgage lenders but not on mortgage brokers. Vermont, for example, requires a mortgage

70. See Kentucky Criminal Background Requirements, available at <http://www.kfi.ky.gov/downloadable/forms/> (select “Criminal Background Requirements” hyperlink) (last visited Apr. 17, 2006) (qualifying the sixty to ninety day expectation with the words, “depending upon how quickly all of the documents are returned to the Department and the backlog of cases”).

71. N.C. GEN. STAT. ANN. § 53-243.05(f) (West, Westlaw through 2005 Reg. Sess.).

72. North Carolina Mortgage Broker Surety Bond, Form MLA007, at 1, available at <http://www.nccob.org/NCCOB/Mortgage/FormsFees/> (follow “MLA007” hyperlink) (last visited Apr. 23, 2006). Similar is Vermont’s Mortgage Broker Surety Bond, available at http://www.bishca.state.vt.us/BankingDiv/lenderapplic/F-2MortgageBrokerSuretyBond_effJul1_05.pdf (last visited Apr. 23, 2006).

73. VT. STAT. ANN. tit. 8, § 2203(a)(2) (Supp. 2005). In a 2005 amendment of this statute, Vermont increased the amount of the surety bond required of mortgage brokers from the former level of \$10,000 to the current level of \$25,000.

74. KY. REV. STAT. ANN. § 294.060(1) (West Supp. 2005); MINN. STAT. ANN. § 58.08, subdiv. 1 (West 2002); N.C. GEN. STAT. ANN. § 53-243.05(f).

lender licensee to maintain liquid assets of \$25,000 in addition to a \$50,000 surety bond.⁷⁵ Although it is true that mortgage lenders have asset needs that are not identical to those of mortgage brokers, requiring mortgage brokers to a meet liquid assets requirement would reduce the number of mortgage brokers who, because their business is thinly capitalized, avoid compensating their victims.⁷⁶

D. Assurance of Broker Competency

Licensing statutes perform another gatekeeping function by imposing a competency requirement as a condition of licensure. The competency requirement protects consumers from applicants who are unfamiliar with mortgage lending products or who are insensitive to predatory lending issues. Verifying pre-licensure competence, which is related to the post-licensure continuing education requirement discussed in Part II.C below, takes varying forms, including education, prior work experience, or a combination of the two.

Kentucky relies upon a formal education requirement. To obtain a mortgage broker's license in Kentucky, a person must certify in the initial application that he or she has "successfully completed an educational training course, approved by the office [of Financial Institutions], of not less than thirty (30) classroom hours' duration."⁷⁷ North Carolina combines the education and experience requirements, with emphasis on the latter. In North Carolina, the applicant must demonstrate "at least three years of experience in residential mortgage lending."⁷⁸ If the applicant does not possess that experience, his or her application can be approved only by "[s]uccessfully complet[ing] both a residential mortgage-lending course approved by the Commissioner of not less than 40 hours of classroom instruction, and a written examination approved by the Commissioner."⁷⁹ Even after satisfying those requirements, the applicant is limited to acting "exclusively as a mortgage broker for a single mortgage banker licensee or single exempt mortgage banker."⁸⁰ Unfortunately, some states impose neither prior education nor prior experience as a requirement for licensure.⁸¹

The competency assurance component of the gatekeeper function would best serve the goal of consumer protection if all applicants were required to complete an educational program prior to obtaining a license. Applicants should be required to pass an examination that confirms their knowledge of real estate financing products and procedures and of the damage predatory lending inflicts on individuals and communities. As will be seen in Part II.E below, the North Carolina licensing statute, which has been an influential model for other states, requires mortgage brokers to make reasonable efforts to "secure a loan that is reasonably advantageous to the borrower considering all the circumstances, including the rates, charges, and

75. VT. STAT. ANN. tit. 8, § 2203(b).

76. See Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 509, 522 (2002).

77. KY. REV. STAT. ANN. § 294.032(6).

78. N.C. GEN. STAT. ANN. § 53-243.05(c)(1).

79. *Id.* § 53-243.05(c)(1a)(a).

80. *Id.* § 53-243.05(c)(1a)(b).

81. For example, there are no such provisions in Minnesota's Residential Mortgage Originator and Servicer Licensing Act or in Vermont's Licensed Lender Act.

repayment terms of the loan and the loan options for which the borrower qualifies.”⁸² This suitability requirement presumes that the broker possesses specific technical knowledge about loan products and procedures.

E. Criteria for Approval or Denial of License Application

A fifth component of the gatekeeping function is found in the criteria that a state establishes for approving or denying a license application. A few criteria are ubiquitous: completing all application documents, clearing personal history and business background checks, and paying application and investigation fees.⁸³ Some states go further, however, and require affirmative findings that echo the character and fitness requirement and the public convenience requirement of other professions or regulated businesses. Unfortunately, the vague language used in these criteria render them difficult to interpret and difficult to apply in a consistent manner. For example, North Carolina’s Mortgage Lending Act establishes two criteria for license approval. First, the applicant must “meet[] the qualifications for licensure” by completing the application forms, clearing the background checks, and paying the required fees.⁸⁴ Second, the Commissioner of Banks must make an affirmative finding that “the financial responsibility, character, and general fitness of the applicant are such as to command the confidence of the community and to warrant belief that the business will be operated honestly and fairly.”⁸⁵ Provided these two criteria are satisfied, the Commissioner “shall issue a license to the applicant.”⁸⁶ The Vermont Licensed Lender Act adds a criterion that approval of the license application “will promote the convenience and advantage of the community.”⁸⁷ Similarly, the Kentucky licensing statute provides that the executive director “shall...inquire into the advisability of approving the application” based on, among other factors, whether the applicant’s “character and general fitness...reasonably warrant the belief that the applicant’s business will be conducted...in such a way as to justify public confidence.”⁸⁸

It is unlikely that such criteria perform any effective gatekeeping function. First, the elements of commanding confidence and expecting an honest and fair business operation are undefined and subjective. What does it mean to “promote the convenience and advantage of the community”? What is necessary to “justify public confidence”? These terms call to mind the discretionary call provisions occasionally found in mortgages.⁸⁹ These clauses, which permit a mortgagee to declare a default and to accelerate repayment of the loan anytime the mortgagee deems itself

82. N.C. GEN. STAT. ANN. § 53-243.10(4).

83. See, e.g., KY. REV. STAT. ANN. § 294.080 (West Supp. 2005); MINN. STAT. ANN. § 58.06 (West 2002); N.C. GEN. STAT. ANN. § 53-243.05(a); VT. STAT. ANN. tit. 8, § 2204(a) (2001).

84. N.C. GEN. STAT. ANN. § 53-243.05(i).

85. *Id.*

86. *Id.*

87. VT. STAT. ANN. tit. 8, § 2204(a)(2).

88. KY. REV. STAT. ANN. § 294.080.

89. These clauses permitted acceleration of a loan if, for any reason, the mortgagee “deems itself ‘insecure.’” See GRANT S. NELSON & DALE A. WHITMAN, CASES AND MATERIALS ON REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 564 (6th ed. 2003). Discretionary call provisions are barred in some anti-predatory lending bills pending in Congress. See H.R. 1182, 109th Cong. § 4 (2005); H.R. 4471, 109th Cong. § 103(i) (2005).

“insecure,” are unnecessary if the mortgagor engaged in some objective behavior, such as failure to make installment payments or remove a lien, that justifies the acceleration. In the absence of a tangible event of default, acceleration by the mortgagee on the ground that it deems itself “insecure” appears arbitrary and is often not enforced.⁹⁰ Similarly, if the license application documents and background checks do not provide the regulator with any objective basis for denying a license, on what ground can the regulator claim that the applicant fails to command the confidence of the community or assert that denial of the license is in the public interest?

Additionally, the licensing statutes establish no procedures for satisfying these requirements. If an affirmative showing of public convenience is needed, there is no mechanism for the applicant to supply it. Thus, the “fitness” criterion adds nothing to the first required finding that the applicant meet the qualifications for licensure and pass the personal history and business background checks. Alternatively, if the “fitness” language imposes an additional requirement but provides no procedure to satisfy it, denial of a license application on that ground would be subject to a due process challenge as an arbitrary exercise of discretion by the commissioner.

The taxonomic approach shows its value in this instance. By establishing functional categories—here a gatekeeping function—we are able to demonstrate that the fitness and convenience criteria, while noble-sounding, are ineffective. If the fitness, convenience, and public interest provisions have any value, it lies in calling attention to the fact that consumers and society expect something more of mortgage brokers than merely the absence of dishonesty. Given the trust and confidence consumers place in mortgage brokers, a trust that the brokers encourage and inculcate, consumers and society expect fair and honest treatment. As this Article maintains in Part III, the hortatory provisions found in broker licensing statutes point toward a reorientation of the borrower-broker relationship from a laissez-faire free contracting model, which is based on liberal notions of utilitarian individualism, to a statutory agency model, which recognizes duties that derive from status and relationship.

F. Use of Application Fees

The categories established in any taxonomy are, to a degree, artificial. Some categories overlap with others, and some components seem to fit in multiple categories or not to fit gracefully in any category. The uses to which license application fees can be put is an example. Some uses, such as paying for background investigation, clearly fall within the gatekeeping function. Other uses, such as promoting consumer education, do not. Nevertheless, for the reader’s convenience, this additional use of application fees is discussed here.

The use of application fees as a means to compel an applicant to internalize some or all of the cost of investigating his or her personal and business background has already been discussed. A second way license-application fees can be put to

90. See *id.* (citing *Wateksa First Nat’l Bank v. Ruda*, 531 N.E.2d 28 (Ill. App. Ct. 1988); *Jackson v. State Bank of Wapello*, 488 N.W.2d 151 (Iowa 1992)).

beneficial use is to dedicate a portion of those fees to consumer education. In Minnesota, for example, \$50 of the \$850 mortgage broker license application fee “is credited to the consumer education account in the special revenue fund.”⁹¹ The Commissioner of Commerce is authorized to use money credited to this consumer education account “for the purpose of making grants to programs and campaigns designed to help consumers avoid being victimized by unscrupulous lenders and mortgage brokers.”⁹²

This use of fees is similar to the practice found in some states where a portion of the mortgage recordation fee is dedicated to consumer education and protection.⁹³ The Minnesota model has the added advantage of collecting the fee from the mortgage broker, often the perpetrator of predatory activities, instead of from the consumer, too often the victim of predation. Although the degree to which consumer education provides an effective response to predatory lending is widely debated,⁹⁴ it is difficult to argue that consumer education does not result in some measure of empowerment for at least some consumers. Accordingly, judged by the criterion of promoting consumer protection, Minnesota’s fee dedication provision is a praiseworthy requirement.⁹⁵

II. THE ADMINISTRATIVE OVERSIGHT FUNCTION

Once an applicant receives a license to engage in mortgage brokering activities, state involvement could end. However, no state that regulates mortgage brokers considers its role restricted to gatekeeping, and each exercises some degree of supervision over a mortgage broker so long as he or she is engaged in business. This post-licensure regulation constitutes the second taxonomic category—the administrative oversight function. As with the gatekeeping category, specific provisions found within the administrative oversight category exhibit variations that can be ranked according to the consumer protection norm. Components of the continuing oversight category include (1) a disclosure correction and update requirement,⁹⁶ (2) a recordkeeping requirement,⁹⁷ (3) a continuing education requirement,⁹⁸ (4) public and private remedies for broker misconduct,⁹⁹ and (5) identification of prohibited and required terms and practices.¹⁰⁰ Unsurprisingly,

91. MINN. STAT. ANN. § 58.10, subdiv. 1 (West 2002).

92. *Id.* § 58.10(3)(a).

93. *See, e.g.*, IND. CODE § 24-9-9-4 (Supp. 2005).

94. For a detailed discussion of the strengths and weaknesses of consumer education as a protection against predatory lending, see Wilson, *supra* note 5, at 1493–96, and the sources cited therein.

95. Consumer education is best viewed as another programmatic response to predatory lending that has its own variations and complexities. As stated at the beginning of this Article, an effective response to predatory lending requires a systematic approach that draws on the benefits provided by multiple, well-thought-out programmatic responses, including consumer empowerment through education.

96. *See, e.g.*, MINN. STAT. ANN. § 58.06, subdiv. 2(a)(2); VT. STAT. ANN. tit. 8, § 2208 (2001).

97. *See, e.g.*, KY. REV. STAT. ANN. §§ 294.140–.170 (West Supp. 2005); MINN. STAT. ANN. § 58.14; N.C. GEN. STAT. ANN. § 53-243.13 (West, Westlaw through 2005 Reg. Sess.); VT. STAT. ANN. tit. 8, § 2223.

98. *See, e.g.*, KY. REV. STAT. ANN. § 294.260; N.C. GEN. STAT. ANN. § 53-243.07; 808 KY. ADMIN. REGS. 12:095 (2006).

99. *See, e.g.*, KY. REV. STAT. ANN. §§ 294.060, 294.990; MINN. STAT. ANN. § 58.08, subdiv. 1; N.C. GEN. STAT. ANN. §§ 53-243.05(f), 53-243.14; VT. STAT. ANN. tit. 8, §§ 2203, 2215 (2001 & Supp. 2005).

100. *See, e.g.*, KY. REV. STAT. ANN. § 294.220; MINN. STAT. ANN. §§ 58.13, 58.136–.137 (West 2002 & Supp. 2006); N.C. GEN. STAT. ANN. § 53-243.11; VT. STAT. ANN. tit. 8, §§ 2210(a), 2218, 2226, 2232a (2001).

variation among the sub-categories increases as we move upward within the category.

A. Disclosure Correction and Update Requirement

Once an applicant receives a license to engage in mortgage brokering activities, the licensee, as a condition of retaining the license, must continue to provide to the state accurate information about both the broker and the broker's business. This duty is manifested in two ways. First, the licensee must correct any incomplete or inaccurate information included on the original license application or the most recent license renewal application.¹⁰¹ Corrective disclosures of this type normally must be transmitted to the state within a relatively short time frame, such as thirty days.¹⁰²

Second, the licensee must report any changes that have occurred since the most recently filed report.¹⁰³ The regulator must be notified of these changes and must approve them if the integrity of the gatekeeping function of the personal history and business background checks is to be preserved. Accordingly, license renewal application forms typically require a licensee to update the personal character and business background information of persons involved in the business.¹⁰⁴ The forms also require a licensee to confirm continued compliance with the surety bond requirement and with the substantive behavioral mandates or prohibitions contained in the licensing statute.¹⁰⁵ Failure to correct and update registration information is grounds for suspension or revocation of the license.¹⁰⁶

To ensure that licensees in fact correct errors and report changes, states must have the authority to examine a broker's files and records. Consent to administrative searches should therefore be a condition of licensure. Further, a state must actually conduct examinations. Examinations should certainly occur anytime there is reason to suspect that a broker has failed to supply truthful and complete information to the state or has engaged in predatory activities. Because red flags may not always be apparent, states should also conduct periodic routine inspections. The cost of routine investigations should be included in the state's license renewal fee, just as the cost of the original personal history and business background investigation should be included in the initial application fee. The cost of a special investigation can be recovered from a licensee, in the form of an administrative assessment, if wrongdoing is discovered.

101. See, e.g., MINN. STAT. ANN. § 58.06, subd. 2(a)(2) (West 2002).

102. See, e.g., *id.* § 58.14, subd. 1; 4 N.C. ADMIN. CODE 3M.0402(a) (2003).

103. See, e.g., VT. STAT. ANN. tit. 8, § 2208; see also 4 N.C. ADMIN. CODE 3M.0402 (2003) (requiring notification "of any material change in any document or information previously submitted to the Commissioner during the application process").

104. See, e.g., North Carolina Lender/Broker Renewal Form, Form MLA0016, available at <http://www.nccob.org/NCCOB/Mortgage/FormsFees/> (follow "MLA0016" hyperlink) (last visited May 27, 2006).

105. *Id.*; MINN. STAT. ANN. § 58.08, subd. 1.

106. See, e.g., KY. REV. STAT. ANN. § 294.090(8); MINN. STAT. ANN. § 58.12, subd. 1(b)(2)(iii); N.C. GEN. STAT. ANN. § 53-243.12(b) (providing that a violation of or failure to comply with any provision of the Mortgage Lending Act, which includes the duty to keep information current, is grounds for revocation, suspension, or non-renewal of a mortgage broker's license); VT. STAT. ANN. tit. 8, § 2210 (providing that a violation of or failure to comply with any provision of the Licensed Lenders Act, which includes the duty to keep information current, is grounds for revocation, suspension, or non-renewal of a mortgage broker's license).

One of the most important continuing disclosure requirements involves contemplated license transfers. Mortgage broker licenses are non-transferable, and any attempt to transfer a license without the state's prior approval is cause for severe sanctions. The administrative regulations that implement North Carolina's Mortgage Lending Act provide:

Any attempt to transfer or assign a license through a change in control without the prior consent of the Commissioner shall:

- (1) be ineffective;
- (2) be grounds for immediate revocation of such license; and
- (3) render the assignor licensee responsible for any and all actions or omissions of its assignee which occur while acting under the apparent authority of such license.¹⁰⁷

Provisions such as this require definitions for the terms "transfer" and "assignment." North Carolina's regulations create a presumption that a transfer occurs in two situations—when there is "any material change in the licensee's organizational structure"¹⁰⁸ and when there is "a change in the identity of a licensee's controlling person."¹⁰⁹

This reference to "controlling person" recalls the discussion of the personal character and business background disclosure function in Part I.B. In that discussion, the definition of "control" was relevant to determining which persons involved with the business were required to complete the self-disclosure portions of the license application form and be subject to investigation. Just as the threshold percentage used by a state in its definition of "control" impacts the gatekeeper function, so too does that percentage impact the state's oversight function. Too high a percentage will permit more unsupervised transfers of controlling power than could occur if a lower threshold were used. Consequently, it is doubly important for consumer protection that a state adopt a low threshold percentage at which the control requirement is met.

B. Recordkeeping Requirement

State licensing statutes require mortgage brokers to maintain records pertaining to their mortgage brokering business. This requirement serves two related functions. First, record preservation facilitates the regulator's power to investigate a licensee's business operations to ensure compliance with applicable statutes and regulations. Vermont's law, for example, declares that the commissioner's investigative powers exist "for the purpose of discovering violations."¹¹⁰ Second, the recordkeeping requirement preserves evidence that can be discovered and used in private legal actions seeking damages or other civil remedies from dishonest mortgage brokers. These important functions raise several related issues, including the scope of documents that must be preserved, the length of time they must be preserved, the format in which they must be preserved, and the place where they must be stored.

107. 4 N.C. ADMIN. CODE 3M.0202(a) (2003).

108. *Id.* at 3M.0202(b).

109. *Id.*

110. VT. STAT. ANN. tit. 8, § 2222(a).

With regard to the records a mortgage broker must preserve, the Vermont Licensed Lenders Act requires mortgage brokers to maintain “the original contract between the mortgage broker and the prospective borrower, a copy of the settlement statement, an account of fees received in connection with the loan, correspondence, papers or records relating to the loan and such other documents as the commissioner may require.”¹¹¹

In addition, the Act provides:

The licensee shall keep, use in the licensee’s business, and make available to the commissioner upon request, such books, accounts, records, and data compilations as will enable the commissioner to determine whether such licensee is complying with the provisions of this chapter and with the rules and regulations lawfully made by the commissioner hereunder.¹¹²

Minnesota’s licensing statute requires a licensee to “keep and maintain...the business records, including advertisements, regarding residential mortgage loans applied for, originated, or serviced in the course of its business.”¹¹³ The specific inclusion of advertising records is beneficial as it could be used by the state or by a consumer to prove a deceptive advertising claim. Minnesota also adds a requirement that if a mortgage broker receives a written consumer complaint, he or she “must investigate and attempt to resolve” that complaint and must “maintain a file containing all materials relating to the complaint and subsequent investigation.”¹¹⁴ These materials could help a consumer prove that a broker made deceptive statements in response to a complaint.

North Carolina requires licensees to “make and keep the accounts, correspondence, memoranda, papers, books, and other records as prescribed by rules adopted by the Commissioner.”¹¹⁵ The Commissioner of Banks has promulgated specific recordkeeping rules that establish categories of documents a licensee must maintain. The central provision of that regulation states:

The licensee shall create and retain a file for each mortgage loan application which shall contain, as applicable, applicant’s name, date, name of person taking the application, HUD-1 Settlement Statement, copies of all agreements or contracts with the applicant, including any commitment and lock-in agreements, and all disclosures required by State and Federal law.¹¹⁶

In addition, licensees in North Carolina are required to maintain (1) “a record of all cash, checks or other monetary instruments received in connection with each mortgage loan application”;¹¹⁷ (2) “a record showing a sequential listing of checks written for each bank account relating to the licensee’s business”;¹¹⁸ (3) “a record

111. *Id.* § 2217(b).

112. *Id.* § 2223.

113. MINN. STAT. ANN. § 58.14, subdiv. 5 (West 2002).

114. *Id.* § 58.14, subdiv. 3.

115. N.C. GEN. STAT. ANN. § 53-243.13(c) (West, Westlaw through 2005 Reg. Sess.).

116. 4 N.C. ADMIN. CODE 3M.0501(c) (2003).

117. *Id.* at 3M.0501(a).

118. *Id.* at 3M.0501(b).

of samples of each piece of advertising relating to the licensee's business";¹¹⁹ and (4) "copies of all contracts, agreements and escrow instructions to or with any depository."¹²⁰

Judged by the criterion of consumer protection, the recordkeeping requirement should be drafted broadly enough to require licensees to preserve any document that could be used by the state to discover and prove a violation of the licensing statute or by consumers to prove predatory conduct. Specifically identifying records to be maintained is a good practice, so long as the list is not deemed to be exclusive.

A second component of the recordkeeping requirement is the length of time that licensees must preserve records. Minnesota requires mortgage brokers to maintain records for twenty-six months.¹²¹ North Carolina requires all records, except advertising samples, to be preserved for three years.¹²² Advertising samples need only be retained for twelve months.¹²³ Vermont has an even longer retention period, requiring in one section that records be retained "for a minimum of six years"¹²⁴ and, in another section, that records be kept and made available to the commissioner "for at least seven years after making the final entry on any loan."¹²⁵

Administrative investigations and legal claims by consumers are better served by a longer record retention term than by a shorter one. Victims of predatory activities by mortgage brokers may be slow to learn that they have been wronged; they may think they are unable to afford an attorney; or they may be disconnected from access to legal services. In these and other circumstances, a mortgage broker should not benefit from a short document retention period that could cause documents to be destroyed before they can be used to prove the existence of wrongdoing. At a minimum, the recordkeeping term should be as long as the longest statute of limitations that could apply to any consumer claim against a mortgage broker.

North Carolina also sets forth specific provisions for the format of and storage location for records that a licensee must preserve. Records must "be maintained in the form of magnetic tape, magnetic disk or other form of computer, electronic or microfilm media available for examination on the basis of computer printed reproduction, video display or other medium that is convertible by the Commissioner into legible, tangible documents."¹²⁶ Additionally, the records must "be secured against unauthorized access and damage" and must be kept "in an accessible location within the State of North Carolina."¹²⁷ Any regulation that helps insure that records are created, preserved, protected, and accessible advances consumer protection.

Finally, the same logic that dictates that the duration of the recordkeeping requirement should coincide with the longest statute of limitations for substantive

119. *Id.* at 3M.0501(d).

120. *Id.* at 3M.0501(e).

121. MINN. STAT. ANN. § 58.14, subd. 3 (West 2002).

122. N.C. GEN. STAT. ANN. § 53-243.13(c) (West, Westlaw through 2005 Reg. Sess.).

123. 4 N.C. ADMIN. CODE 3M.0501(d).

124. VT. STAT. ANN. tit. 8, § 2217(b) (2001).

125. *Id.* § 2223. This section and section 2217 seem to describe the same documents, despite the difference in retention periods.

126. 4 N.C. ADMIN. CODE 3M.0502(b).

127. *Id.* at 3M.0502(d).

causes of action also dictates that a broker's surety bond should have a term at least as long. As a result, it is inadequate to require a licensee to be covered by a surety bond only when the broker's license is active. "Tail coverage" must be kept in force until all applicable statutes of limitation have expired. Evidence, causes of action, and a source of recovery are interconnected. The loss of one could render the others meaningless.

C. Continuing Education Requirement

A third aspect of a state's power to oversee mortgage broker licensees that can be used to promote consumer protection is a continuing education requirement. Continuing education should build upon a system of pre-licensure education and skills testing as discussed in Part I.D. Both the number of continuing education credits required on an annual basis and the content of the continuing education classes are relevant to the goal of consumer protection.

Vermont and Minnesota do not impose any continuing education requirements on mortgage brokers. This is not a desirable approach. Given the incidence of predatory activities by mortgage brokers and the absence of any self-regulating organization to impose and enforce standards of conduct,¹²⁸ continuing education provides an important tool for communicating both the behavior expected of brokers and the procedures for holding predatory lenders responsible for the harm they cause. Continuing education also provides an opportunity to channel broker behavior in a positive direction by emphasizing the destructive effects of predatory lending.

In North Carolina, the goal of continuing education is identified as "enhancing the professional competence and professional responsibility of all licensees."¹²⁹ The fact that the goals of competence and responsibility are singled out for emphasis signals their too frequent absence in the mortgage brokering business. The North Carolina legislature has empowered the Commissioner of Banks to require continuing professional education "not [to] exceed eight credit hours within a one-year period."¹³⁰ In Kentucky, completion of "at least twelve (12) hours of continuing professional education"¹³¹ each year is a prerequisite for license renewal.

States can promote consumers' interests by mandating the content of continuing education instruction. North Carolina and Kentucky require state approval of both the continuing education providers and the course content.¹³² At a minimum, continuing education should include instruction on the many kinds of mortgage financing products available in the market and on foreclosure risks and procedures. A mortgage broker must possess this information to be able to select an appropriate loan product and to inform a borrower about the repercussions of default.

128. See Elizabeth Renuart, *Toward One Competitive and Fair Mortgage Market: Suggested Reforms in A Tale of Three Markets Point in the Right Direction*, 82 TEX. L. REV. 421, 433-34 (2003).

129. N.C. GEN. STAT. ANN. § 53-243.07(a) (West, Westlaw through 2005 Reg. Sess.).

130. *Id.* § 53-243.07(b).

131. KY. REV. STAT. ANN. § 294.260(1) (West Supp. 2005).

132. N.C. GEN. STAT. ANN. § 53-243.07(b); KY. REV. STAT. ANN. § 294.260(5); 4 N.C. ADMIN. CODE 3M.0301.

In addition, continuing education should include, as it does in Kentucky, specific instruction on predatory lending. Kentucky ensures that at least a portion of a licensee's continuing professional education addresses that topic as the Kentucky Commissioner of Financial Institutions requires that,

[o]f the twelve (12) hours of continuing education required every year, registered mortgage loan brokers...shall complete a minimum of six (6) continuing education hours at least once every two (2) years on the requirements of either KRS Chapter 294 [the Mortgage Loan Broker Act] or KRS 360.100 [the High Cost Home Loan Act] or a combination of both.¹³³

The regulation further specifies that “[o]nly the provisions of KRS 360.100 pertaining to predatory lending and penalties for noncompliance may be included in the education requirements.”¹³⁴ These provisions advance consumer protection and should be emulated in other states. Mortgage brokers should be made to confront the damage caused by predatory lending, including the economic and psychological harms to the borrower and the borrower's family and the social harms inflicted on neighborhoods and cities.¹³⁵ By raising awareness of these harms, perhaps at least some mortgage brokers may be channeled away from predatory activities.

D. Public and Private Remedies

An important component of the oversight function of mortgage broker licensing statutes is the state's power to discipline brokers who engage in undesirable behaviors. States police the mortgage brokering industry through the sanctions and remedies made available to the regulatory agency charged with oversight and to private parties who are wronged by mortgage brokers.

The administrative sanctions available to state regulators include the power to control the license and to impose sanctions against a licensee. Upon the violation of any provision of the licensing statute, states empower the relevant regulator to suspend, revoke, or refuse to renew a broker's license.¹³⁶ Regulators also have powers that stop short of suspension, revocation, or non-renewal, including the power to “restrict or limit the activities relating to mortgage loans of any licensee”¹³⁷ and the power to issue cease and desist orders.¹³⁸

These sanctions are effective because loss of the license puts a mortgage broker out of business.¹³⁹ A person who brokers a loan without a license is subject to criminal prosecution, and any loan made by an unlicensed person will be treated as

133. 808 KY. ADMIN. REGS. 12:095(1)(1) (2005).

134. *Id.* at 12:095(1)(2).

135. For a discussion of the damage to individuals, both economic and personal, and the damage to society caused by predatory lending, see Wilson, *supra* note 5, at 1481–84.

136. See, e.g., KY. REV. STAT. ANN. § 294.090; MINN. STAT. ANN. § 58.12 (West 2002); N.C. GEN. STAT. ANN. § 53-243.12; VT. STAT. ANN. tit. 8, § 2210 (2001).

137. N.C. GEN. STAT. ANN. § 53-243.12(a).

138. See, e.g., VT. STAT. ANN. tit. 8, § 2210(a).

139. See, e.g., KY. REV. STAT. ANN. § 294.265(2) (“Persons whose registration or license has been denied, suspended, or revoked under this section are prohibited from participating in any business activity of a registrant or licensee under this chapter....”).

wholly or partially unenforceable. In Vermont, if a loan contract is knowingly and willfully made in violation of the license requirement of the Licensed Lender Act, “the lender shall have no right to collect or receive any principal, interest, or charges whatsoever,” but “where no finding of a knowing and willful violation is made, the lender shall have no right to collect or receive any interest or charges whatsoever, but shall have the right to collect and receive principal.”¹⁴⁰ Kentucky similarly limits enforceability of a loan brokered by a person who does not have a valid license.¹⁴¹ If needed, the regulator can initiate judicial proceedings to obtain an injunction, restraining order, mandamus, or appointment of a receiver over the licensee’s assets.¹⁴²

In addition to license-directed sanctions, mortgage broker statutes include a variety of fines and criminal sanctions. The regulator can levy an administrative penalty against the broker for violating any provision in the licensing statute. These penalties range from \$1,000 per violation in Vermont¹⁴³ to \$5,000 per violation in Kentucky.¹⁴⁴ A broker can also face criminal charges, punishable by fine or imprisonment. In Kentucky, a broker who willfully violates the statute can be charged with a class D felony,¹⁴⁵ and in North Carolina it is a class I felony to broker a mortgage loan without a license, with each transaction being treated as a separate offense.¹⁴⁶ A licensing statute should make clear that enumerated sanctions supplement sanctions available under other statutes or regulations and do not limit the power of the state to charge a broker with violating other criminal statutes.¹⁴⁷

An additional sanction, public censure, is exercised in Minnesota.¹⁴⁸ Censure produces both oversight and consumer education benefits by publishing, on the Department of Commerce’s website, the names of dishonest mortgage brokers and a brief description of their offense.¹⁴⁹ Such electronic pillorying serves at least three purposes. First, if the broker’s license has been re-activated following a suspension or has been the subject of some lesser sanction or order, publication of that broker’s name will help consumers avoid doing business with him or her. Second, if the broker’s license has been terminated, publication warns consumers not to do business with that broker and alerts consumers to the types of behaviors another broker could exhibit. Finally, the threat of having one’s name published on a state website for engaging in predatory or fraudulent activities may dissuade some brokers from committing those acts.

140. VT. STAT. ANN. tit. 8, § 2215(c)(1) (2001). The impact of the holder in due course doctrine on rules like section 2215 is not resolved. *See Eggert, supra* note 76.

141. KY. REV. STAT. ANN. § 294.030(3).

142. *Id.* § 294.190(2)(b).

143. VT. STAT. ANN. tit. 8, § 2215(a)(1).

144. KY. REV. STAT. ANN. § 294.990(5).

145. *Id.* § 294.990(1).

146. N.C. GEN. STAT. ANN. § 53-243.14 (West, Westlaw through 2005 Reg. Sess.).

147. *See, e.g.,* KY. REV. STAT. ANN. § 294.265(5) (“The provisions of this section [on sanctions and penalties] shall be in addition to any other penalties or remedies available....”).

148. MINN. STAT. ANN. § 58.12, subdiv. 1(a)(3) (West 2002).

149. The Minnesota Department of Commerce website contains a page entitled “Enforcement Actions,” which links to “Recent administrative actions taken against licensed individuals or businesses.” Minnesota Commerce: Enforcement Actions, <http://www.state.mn.us> (follow “State Agencies” hyperlink; then follow “Commerce Department” hyperlink; then follow “Enforcement Actions”) (last visited Apr. 16, 2006).

Equally important as these public remedies is the availability of private civil remedies for consumers who incur damages at the hands of a mortgage broker. Although mortgage broker licensing statutes often contain lengthy provisions detailing prohibited conduct,¹⁵⁰ their treatment of private remedies is comparatively short. Some statutes do not mention any private remedies other than an action against the surety bond.¹⁵¹ Other statutes identify one or more additional remedies for the borrower-consumer. For example, the Vermont Licensed Lender Act empowers the Commissioner to “[o]rder any person to make restitution to any person injured as a result of a violation of this chapter.”¹⁵² Kentucky’s Mortgage Loan Broker Act provides that a consumer “may sue at law or equity for damages” that result from a broker’s “[f]ailure...to fulfill the terms of any loan commitment, letter of commitment, agreement, or contract for the loan of money within the time and on such terms specified therein, or the failure to make a bona fide effort to secure a loan after receiving a fee for such service.”¹⁵³ The availability of these private remedies benefits consumers. A cause of action is cold comfort, however, if the offending broker is unable to pay a judgment entered against him or her.

Licensing statutes provide one possible source of recovery by requiring a mortgage broker to post a surety bond. Issues relating to the amount of bond were discussed in Part I.C in connection with the broker’s initial license application. The points made there, especially those concerning the bond amount and the lack of a liquid assets requirement for mortgage brokers, apply equally here. In addition, the oversight function raises an issue that was not directly involved in the gatekeeping function—the ability of a consumer to pursue a direct action against the bond to recover damages for a broker’s violation of the licensing statute.

Licensing statutes often state that “[t]he bond shall run to the state for the use of the state and of any person or persons who may have cause of action against the obligor of such bond under the provisions of this chapter.”¹⁵⁴ This language does not specifically state whether consumers may file a direct action against the bond or whether the state must initiate the action on behalf of the consumer. While a private right of action may be inferred, especially in light of a further provision stating that the obligor “will pay to the state and to any such person or persons any and all moneys that may become due or owing to the state or to such person or persons,”¹⁵⁵ the issue is not free from uncertainty. Indeed, the existence of a private right of action has been challenged with regard to a licensing statute similar to Vermont’s Act.¹⁵⁶

150. See, e.g., KY. REV. STAT. ANN. §§ 294.090(1)–(12); MINN. STAT. ANN. § 58.12, subdiv. 1(b)(2)(i)–(xi); N.C. GEN. STAT. ANN. § 53–243.11 (West, Westlaw through 2005 Regular Sess.).

151. For example, there are no private civil remedies, other than proceeding against the broker’s surety bond, in North Carolina’s Mortgage Lending Act. See N.C. GEN. STAT. ANN. § 53–243.05(f). The same is true of Minnesota’s Residential Mortgage Originator and Servicer Licensing Act. See MINN. STAT. ANN. § 58.08, subdiv. 1 (West 2002 & Supp. 2006).

152. VT. STAT. ANN. tit. 8, § 2215(a)(2) (2001).

153. KY. REV. STAT. ANN. § 294.120(8).

154. See, e.g., VT. STAT. ANN. tit. 8, § 2203(a) (Supp. 2005).

155. *Id.*

156. See *Becker v. Four Points Inv. Corp.*, 708 N.E.2d 29 (Ind. Ct. App. 1999). The bond form required by the Indiana Securities Commissioner provides that the bond is “for the use and benefit of all persons damaged by the breach of any of the conditions of this obligation” and furthermore that “[e]very person who has a cause of

Licensing statutes in North Carolina, Kentucky, and Minnesota remove any doubt about the availability of a private right of action by a consumer. The North Carolina statute provides that “[a] party having a claim against the licensee may bring suit directly on the surety bond,”¹⁵⁷ while also preserving the option that “the Commissioner may bring suit on behalf of any claimants, either in one action or in successive actions.”¹⁵⁸ Minnesota’s statute addresses the expenses and damages that individuals may be recover from the surety bond:

The bond... must be available for the recovery of expenses, fines, and fees levied by the commissioner under this chapter relating to servicing, and for losses or damages incurred by borrowers as the result of a licensee’s servicing-related noncompliance with the requirements of this chapter [with other chapters in the Minnesota code], or breach of contract.¹⁵⁹

Licensing statutes should also establish a procedure to be used in those cases where sums sought by the state for administrative fines and by a consumer for damages exceed the bond amount, a contingency that once more supports raising the required amount of the bond. While Minnesota’s statute is silent on the issue, North Carolina rightly resolves the question in favor of the consumer by providing that “[c]onsumer claims shall be given priority in recovering from the bond.”¹⁶⁰

Judged by the taxonomic norm of consumer protection, a licensing statute should specifically provide for a private right of action by the consumer. A state attorney general’s office is subject to staffing and budget limitations that could restrict the effectiveness of the bond as a remedy if a consumer were required to assert a claim against the surety bond through the state. Private parties represented by attorneys do not suffer from these limitations and can police the mortgage brokering industry more effectively than the public sector can do alone. The effectiveness of a “private attorneys general” approach is likely to be even greater when a licensing statute awards attorney’s fees to a consumer for a successful action against a broker, as is the case in Kentucky for specified misconduct.¹⁶¹

Another bond-related issue raised by licensing statutes is the state’s power to require a broker to increase the bond amount. The key to the exercise of this power is a statute’s definition of the conditions that must exist before the state can compel an increase. In Vermont, the commissioner must determine that the licensee’s bond is “insecure, exhausted, insufficient, or otherwise doubtful.”¹⁶² Upon that finding,

action under [the mortgage broker licensing statute] may bring action upon this bond to enforce any liability on the bond.” Indiana Loan Broker’s Bond, *available at* <http://www.in.gov/icpr/webfile/formsdiv/38168.pdf> (last visited May 9, 2006). The court in *Becker* stated:

[R]ecogniz[ing] that the proper way to bring the action is in the name of the State of Indiana on the relation of the plaintiff...., Ind. Trial Rule 17(A)(2) provides that “[w]hen a statute provides for an action by this state on the relation of another, the action may be brought in the name of the person for whose use or benefit the statute was intended.”

Becker, 708 N.E.2d at 32 (third alteration in original).

157. N.C. GEN. STAT. ANN. § 53–243.05(f) (West, Westlaw through 2005 Reg. Sess.).

158. *Id.*

159. MINN. STAT. ANN. § 58.08, subd. 1 (West 2002).

160. N.C. GEN. STAT. ANN. § 53–243.05(f).

161. *See* KY. REV. STAT. ANN. § 294.120(8) (West Supp. 2005).

162. VT. STAT. ANN. tit. 8, § 2207(a) (2001).

the commissioner may require the licensee to post “one or more additional bonds.” Similarly, in Kentucky, the commissioner can require “the filing of a new or supplemental bond” upon a “reasonable determin[ation] that the bond...[is] insecure, deficient in amount, or exhausted in whole or part.”¹⁶³ North Carolina and Minnesota do not provide for increasing the amount of the bond.

The power to require an increase in the amount of the surety bond benefits consumers for the obvious reason that a larger bond increases the availability of assets to pay consumer claims. At the same time, the limitations of this remedy must be acknowledged. Increasing the bond amount will work best when a mortgage broker’s transgression is small enough that he or she is subject to sanction but is still allowed to remain in business. In that circumstance, the higher bond amount corresponds to the increased risk that other claims might surface based on past conduct or that a subsequent transgression might occur.

Increasing the bond amount is not a helpful option, however, when the wrongdoing has been so egregious that the broker’s license is revoked. In such a case, victims of a broker’s worst behavior have recourse only to the original face amount of the bond. For these consumers, the power to increase the bond amount is “too little, too late.” This fact demonstrates once more the need for higher bond amounts than are currently required and the need for a liquid assets requirement for mortgage brokers.¹⁶⁴

The effectiveness of sanctions and remedies also depends on when they can be invoked, that is, they depend on the statutory definition of the actions or omissions that constitute a violation. Accordingly, licensing statutes should give special attention to identifying both mandated and prohibited conduct. That topic is addressed in the next section.

E. Prohibited and Required Terms and Practices

The conduct regulating function within the oversight category involves a combination of provisions that proscribe some acts, prescribe other acts, and announce general standards of behavior. As argued in Part III, the general standards of desirable behavior represent a laudable but incomplete effort to re-define the nature of the relationship between a borrower and a mortgage broker. In so doing, these standards anticipate the broker-borrower orientation function of the next, and highest, taxonomic category. Prior to discussing those provisions, however, this Article first examines the provisions that regulate specific loan terms and broker practices, including required disclosures.

Some provisions of mortgage broker licensing statutes seek to combat predatory behavior by prohibiting products, terms, and broker practices that can be used to exploit consumers. A sizeable number of such provisions could be listed. Some examples found in broker licensing statutes include (1) limiting the maximum term for loans secured by first and subordinate liens;¹⁶⁵ (2) limiting the amount of loan

163. KY. REV. STAT. ANN. § 294.060(3).

164. See *supra* notes 75–76 and accompanying text.

165. VT. STAT. ANN. tit. 8, § 2216(1)–(2) (2001).

application fees a broker may charge;¹⁶⁶ (3) requiring a mortgage to be executed for each loan;¹⁶⁷ (4) requiring the mortgage to be recorded in the public recording system;¹⁶⁸ (5) prohibiting liens against real estate unless the principal amount of the loan exceeds a stated minimum;¹⁶⁹ (6) requiring payment amounts to be computed by a prescribed method,¹⁷⁰ including calculating interest based on a 365-day year;¹⁷¹ (7) prohibiting collection of interest paid in advance;¹⁷² (8) limiting the amount of delinquency fees¹⁷³ and pre-payment penalties that may be charged;¹⁷⁴ and (9) prohibiting the capitalization of a lender's fees in excess of a specified amount.¹⁷⁵ These substantive limitations and requirements complement the limitations and requirements contained in state high-cost lending statutes and in the federal Home Ownership and Equity Protection Act.¹⁷⁶

Restrictions on mortgage lending procedures, in addition to restrictions on mortgage loan products and terms, are necessary for two reasons. First, some loan terms that are not inherently predatory can be misused and thereby become tools of predation, such as when a predatory broker uses a balloon payment feature to lock a borrower into an unavoidable, fee-laden refinancing of the loan. Second, many procedures, although possibly not rising to the level of fraud, are calculated to mislead or coerce.¹⁷⁷

As with loan terms, licensing statutes often specifically identify prohibited or mandated procedures. For example, statutes often require brokers to maintain a separate bank account for borrowers' funds, prohibit brokers from mingling borrowers' funds with their own,¹⁷⁸ and prohibit withdrawal of any funds from the dedicated account until the loan is closed.¹⁷⁹ Brokers are permitted to work only with lenders who are licensed under the same statute¹⁸⁰ and are prohibited from advertising a loan product unless they are in fact able to offer it.¹⁸¹ Brokers are required to "make a bona fide effort to secure a loan after receiving a fee"¹⁸² and are prohibited from making any misrepresentation about the borrower's ability to qualify for a mortgage product.¹⁸³ Brokers may not make "any residential mortgage loan with the intent that the loan will not be repaid and that the residential mortgage

166. KY. REV. STAT. ANN. § 294.120(6).

167. *Id.* § 294.110(2) (West 2001).

168. *Id.*

169. VT. STAT. ANN. tit. 8, § 2216(3).

170. *Id.* § 2216(4).

171. *Id.* § 2230(b).

172. *Id.*

173. KY. REV. STAT. ANN. § 294.110(3).

174. *Id.* § 294.110(4); MINN. STAT. ANN. § 58.137, subd. 2 (West Supp. 2006); N.C. GEN. STAT. ANN. § 53-243.11(10) (West, Westlaw through 2005 Reg. Sess.); VT. STAT. ANN. tit. 8, § 2232a(d).

175. MINN. STAT. ANN. § 58.137, subd. 1.

176. See 15 U.S.C. § 1602(aa) (2000).

177. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1268-70 (2002).

178. See, e.g., MINN. STAT. ANN. § 58.13, subd. 1(2).

179. See, e.g., VT. STAT. ANN. tit. 8, § 2218(c).

180. See, e.g., MINN. STAT. ANN. § 58.13, subd. 1(14); VT. STAT. ANN. tit. 8, § 2216.

181. See, e.g., N.C. GEN. STAT. ANN. § 53-243.11(6) (West, Westlaw through 2005 Regular Sess.).

182. KY. REV. STAT. ANN. § 294.120(8) (West Supp. 2005).

183. See, e.g., MINN. STAT. ANN. § 58.13, subd. 1(9).

originator will obtain title to the property through foreclosure.”¹⁸⁴ Brokers must promptly disburse loan proceeds and are prohibited from “delay[ing]...closing of any mortgage loan for the purpose of increasing interest, costs, fees, or charges payable by the borrower.”¹⁸⁵ Further, brokers may not delay the issuance of a loan pay-off letter or payment history record¹⁸⁶ or charge a fee for providing a payoff amount or payment history.¹⁸⁷ Finally, when the loan is paid, brokers must mark the promissory note “paid” and promptly release the mortgage.¹⁸⁸

Minnesota’s Residential Mortgage Originator and Servicer Licensing Act includes a provision that bridges the product-procedure distinction and points toward the imposition of behavior standards. Pursuant to a section entitled “Standards of Conduct,” a mortgage broker shall not, without the borrower’s consent, “make, provide, or arrange for a residential mortgage loan that is of a lower investment grade if the borrower’s credit score...indicates that the borrower may qualify for a residential mortgage loan, available from or through the originator, that is of a higher investment grade.”¹⁸⁹ On the one hand, this prohibition addresses a term of the loan, the interest rate of the note; on the other hand, the prohibition establishes a conduct norm that rejects the predatory practice of steering, which occurs when a broker coerces a borrower to agree to pay a higher interest rate than is justified by the borrower’s risk of default, as measured by his or her credit score.

Another set of conduct-directed regulations focuses on fraud-like practices. Under these regulations, brokers are prohibited from making false, misleading, or deceptive statements, whether directly to borrowers or in advertisements. A broker’s license can be revoked if he or she “[h]as made any misrepresentations or false statements to, or concealed any essential or material fact from, any person in the course of acting as a mortgage loan company or loan broker.”¹⁹⁰ This provision is supplemented by another that makes it unlawful

for any...mortgage loan broker, in connection with the operation of a mortgage loan business...directly or indirectly:

(a) [t]o employ a device, scheme, or artifice to defraud; [or]

(b) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.¹⁹¹

In Minnesota, a statement is “misleading” if it “has the capacity or tendency to deceive or mislead a borrower.”¹⁹² In North Carolina, a statement is misleading if it is likely “to influence, persuade, or induce an applicant...to take a mortgage loan.”¹⁹³ In Minnesota, the commissioner is instructed to

184. *Id.* § 58.13(1)(13).

185. KY. REV. STAT. ANN. § 294.220(2)(d); *see also* MINN. STAT. ANN. § 58.13, subdiv. 1(3).

186. *See, e.g.*, KY. REV. STAT. ANN. § 294.220(2)(e).

187. *See, e.g., id.* § 294.220(2)(f); VT. STAT. ANN. tit. 8, § 2232a(c) (2001).

188. *See, e.g.*, N.C. GEN. STAT. ANN. § 53-243.11(2) (West, Westlaw through 2005 Reg. Sess.); VT. STAT. ANN. tit. 8, § 2232a(e). Although certain of these prohibitions may affect lenders more frequently than others, all prohibitions are directed equally at both groups.

189. MINN. STAT. ANN. § 58.13, subdiv. 1(18).

190. KY. REV. STAT. ANN. § 294.090(7).

191. *Id.* § 294.220(2).

192. MINN. STAT. ANN. § 58.13, subdiv. 2.

193. N.C. GEN. STAT. ANN. § 53-243.11(1).

consider the following factors in deciding whether a statement, representation, or advertisement is deceptive or misleading: the overall impression that the statement, representation, or advertisement reasonably creates; the particular type of audience to which it is directed; and whether it may be reasonably comprehended by the segment of the public to which it is directed.¹⁹⁴

By making the issue of deception context specific and borrower sensitive, the Minnesota statute provides a useful tool for addressing predatory brokers' intentional targeting of unsophisticated consumers.

Because prohibiting only specifically identified conduct leaves too much room for mortgage brokers to craft other ways to harm consumers and does not lead to the kind of behavior that consumers and society should expect, broker licensing statutes supplement rules with standards. Behavior standards can be stated in either negative or positive terms, but the underlying idea is that the mortgage broker is required to deal with the consumer in a way that exceeds merely avoiding wrongdoing. For example, the North Carolina Mortgage Lending Act prohibits mortgage brokers from engaging in any act or practice in connection with any mortgage loan that "is not in good faith or fair dealing."¹⁹⁵ The Vermont Licensed Lender Act authorizes the banking commissioner to suspend or revoke a broker's license if that broker engages in "unconscionable conduct which takes advantage of a borrower's lack of bargaining power or lack of understanding of the terms or consequences of the transaction."¹⁹⁶ This prohibition goes to the underlying problem of the informational and power asymmetries that plague the liberal model of contract formation within the sub-prime lending market.

North Carolina's licensing statute provides a particularly interesting model for structuring the mortgage broker-consumer relationship. The Mortgage Lending Act distills the conduct standards into four statutory duties that are imposed on all mortgage brokers. The statute provides:

A mortgage broker...shall, in addition to duties imposed by other statute or at common law:

- (1) Safeguard and account for any money handled for the borrower;
- (2) Follow reasonable and lawful instructions from the borrower;
- (3) Act with reasonable skill, care, and diligence; and
- (4) Make reasonable efforts, with lenders with whom the broker regularly does business to secure a loan that is reasonably advantageous to the borrower considering all the circumstances, including the rates, charges, and repayment terms of the loan and the loan options for which the borrower qualifies with such lenders.¹⁹⁷

The provisions of this section merit close attention. The first three are restatements of fundamental duties an agent owes to a principal in an agency relationship. The first is a duty to account, which can be found in section 382 of the *Restatement*

194. MINN. STAT. ANN. § 58.13, subd. 2.

195. N.C. GEN. STAT. ANN. § 53-243.11(8).

196. VT. STAT. ANN. tit. 8, § 2210(a)(3) (2001).

197. N.C. GEN. STAT. ANN. § 53-243.10.

(*Second*) of Agency.¹⁹⁸ The second is a duty to follow instructions, which can be found in section 385.¹⁹⁹ The third is a duty to act with reasonable care, which can be found in section 379.²⁰⁰

While the North Carolina statute may state these duties with unique clarity, the idea that a mortgage broker owes at least some fiduciary duties to a borrower can also be found in the licensing statutes of other states. For example, the licensing statute in Vermont provides that funds paid by a prospective borrower must be deposited into a segregated account and, with regard to such funds, the mortgage broker “shall act as a fiduciary.”²⁰¹

The important question then becomes, what is—or what should be—the nature of the relationship that licensing statutes establish between a mortgage broker and a consumer-borrower. Answering that question is the task of the third taxonomic category considered below.

III. THE RELATIONSHIP DEFINING FUNCTION

Although all mortgage broker licensing statutes regulate broker activities by prohibiting or mandating specific loan terms, products, and procedures, statutes in a few states go farther. These statutes attempt to define the nature of the relationship between the broker and the borrower in the loan transaction. Three broker-borrower orientation models can be identified: (1) a contractual duty model,²⁰² (2) an optional quasi-agency duty model,²⁰³ and (3) a mandatory quasi-agency duty model.²⁰⁴ These models will be analyzed on their own terms and as steps along the way to a full agency regime.

It is first appropriate to acknowledge that each of these models represents an advance over licensing statutes that do nothing to define the mortgage broker-borrower relationship and remain rooted in a liberal model of contract formation, in which information and power asymmetries are exploited in the name of utilitarian individualism. Even so, the orientation models can themselves be ranked according to the taxonomic standard of consumer protection. Even with its imperfections, the optional agency duty model is preferable to the contract duty model; similarly, the mandatory quasi-agency duty model is preferable to the opt-in model.

This Part concludes with an argument that these three models represent incremental movement toward a statutory agency regime in which mortgage brokers owe agency duties to their borrower-customers. Imposing an agency regime in real estate mortgage brokering, as has been done in the closely related field of real estate sales brokering, will serve several ends. First, an agency regime will provide a theoretical foundation for the loan term, product, and behavior prohibitions and mandates that already exist. Second, it will provide a basis for prohibiting other behaviors, including yield-spread premiums, that harm consumers but are permitted.

198. RESTATEMENT (SECOND) OF AGENCY § 382 (1958).

199. *Id.* § 385, at 192–93.

200. *Id.* § 379, at 177.

201. VT. STAT. ANN. tit. 8, § 2218(a).

202. *See infra* Part III.A.

203. *See infra* Part III.B.

204. *See infra* Part III.C.

Finally, an agency regime can channel mortgage broker behavior away from predatory acts and toward fair and honest service, either by elevating the expected standard of conduct for brokers or by creating a real threat of liability for failing to comply with the duties an agent owes to a principal.

A. *The Contractual Duty Model*

One attempt to protect consumers from brokers' predatory acts is found in statutes that require a written contract between the mortgage broker and the borrower-consumer and dictate important terms that must be included in the contract. Such a contractual duty model exists in Vermont. Unfortunately for consumers, despite a seemingly promising introduction, the contract that results from the statute does more to confirm that the borrower is left to protect him- or herself than to require the broker to abandon predatory behaviors.

Section 2219 of Vermont's Licensed Lenders Act begins:

In advance of taking any fee or collecting any charges, or at the time the prospective borrower submits a signed application, a written agreement in a form approved by the commissioner shall be prepared by the mortgage broker, and shall be signed by both the mortgage broker and the prospective borrower.²⁰⁵

There are two important components to this provision. First, the contract must be executed before the borrower parts with any money or completes a loan application. Second, it requires the mortgage broker to use the contract form prescribed by the commissioner. By controlling the form of the contract, section 2219 precludes the broker from constructing a contract that is procedurally unfair.

The statute also addresses the substantive content of the prescribed contract:

The agreement shall set forth the particulars of the service to be performed by the mortgage broker, including specifics as to what shall constitute reasonable efforts on the part of the mortgage broker to perform the agreed upon services, shall state clearly that the mortgage broker shall represent the interests of the prospective borrower rather than those of any lender, and shall state the fee for the services.²⁰⁶

Including the particulars and specifics regarding the broker's services can help ensure that the borrower-consumer's expectations are going to be fulfilled or will alert the borrower that his or her relationship with the broker will be different than anticipated. Clearly stating the fee charged by the broker can also aid consumer understanding and prevent surprise fees and charges at the closing table, which, because of the compressed time frame that characterizes most closings, is far from a good time for a borrower to challenge a fee. Of course, neither statement ensures that the broker will not impose different terms at the closing table, an accusation often made against predatory brokers. Such abusive behavior might, however, be addressed by the penultimate clause of the section.

205. VT. STAT. ANN. tit. 8, § 2219 (2001).

206. *Id.*

Perhaps the most promising provision of section 2219 is the requirement that the broker “state clearly that the mortgage broker shall represent the interests of the prospective borrower rather than those of any lender.”²⁰⁷ One of the characteristics of a predatory mortgage broker is that the broker inculcates feelings of friendship and trust in the borrower-consumer. The mortgage broker feeds the borrower’s assumption that because the broker will be *working with* the borrower that broker will also be *working for* the borrower.²⁰⁸ Mortgage broker advertisements talk of “helping” the borrower by arranging for loans that will “meet the borrower’s needs,” will “solve the borrower’s problems,” and will “free” the borrower from debt concerns. When a mortgage broker engages in predatory behavior, there is harm instead of help, more problems instead of a solution, and more debt concerns instead of fewer. In most instances, the borrower learns too late that his or her reliance on and trust in the broker were not only factually misplaced but were also legally incorrect as the broker owes no duty to protect the borrower’s interests.²⁰⁹ Section 2219 appears to address the disconnection between expectation and legal reality by requiring the broker to “represent the interests of the prospective borrower.”²¹⁰

Unfortunately, the contract form prescribed by the Commissioner of the Vermont Banking, Insurance, Securities, and Health Care Administration takes away any consumer protection that might have been intended by the statute. The regulation that implements the contract requirement of section 2219 is Vermont Banking Division Regulation B-96-1, section 4.²¹¹ The principal contribution of this regulation is to refer the reader to an appendix that “contains a form which is approved by the Commissioner.”²¹² From a consumer’s point of view, the prescribed form is disappointing.

The Broker/Prospective Borrower Agreement consists of five laconic paragraphs. There is precious little good news in them for borrower-consumers. Paragraph one states, “[Mortgage broker], acting in a brokerage capacity will provide the following services in assisting Prospective Borrower(s) to secure financing for the above-referenced property: mortgage program explanations; application completion assistance; loan commitment acceptance coordination. [Mortgage broker] will not be making the loan to Prospective Borrower(s).”²¹³

This list of services falls short of the “particulars” and “specifics” required by section 2219. These services are either ministerial only (“application completion assistance” and “loan acceptance coordination”) or are so vague (“mortgage

207. *Id.*

208. For a more detailed discussion of mortgage broker efforts to inculcate a sense of trust by the borrower-consumer, see Wilson, *supra* note 5, at 1475–76.

209. For a more detailed discussion of the disconnection between borrower expectations and legal reality, see *id.* at 1504.

210. VT. STAT. ANN. tit. 8, § 2219.

211. Vt. Banking Div. Reg. B-96-1, § 4, available at http://www.bishca.state.vt.us/RegsBulls/bnkregs/REG_B-96-1.htm (last visited Apr. 17, 2006) [hereinafter Regulation B-96-1].

212. *Id.*

213. *Id.*, app. The brackets and parentheses appear in the original. The brackets represent a “field,” with the intent that a specific broker’s name be inserted; the parentheses address the singular/plural distinctions for number and grammatical case. The Broker/Prospective Borrower Agreement will be reproduced in this Article as it appears in the original and without the use of “sic.”

program explanations”) that they provide little guidance for what a consumer can expect from a broker. There are many ways a broker can color the “explanation” of mortgage-based financing products to direct or coerce a borrower into accepting a loan that benefits the broker at the expense of the borrower.

Paragraph two of the Agreement begins on an encouraging note as it states: “[Mortgage broker] represents the interests of Prospective Borrower(s) while performing the above services.”²¹⁴ Initially, there is hope that this requirement will insure that the “mortgage program explanations” will be accurate, complete, and directed at making a loan that is in the borrower’s interest. The next sentence, however, sounds an ominous note by providing that the broker’s services “are consultative only.”²¹⁵ Any uncertainty about what it means legally for services to be “consultative only” is quickly cleared up. Paragraph two continues: “Prospective Borrower(s) will rely on his/her/their own judgment in deciding which available loan product best suits Prospective Borrower’s(s’) needs and financial means. Prospective Borrower(s) is/are not relying on [mortgage broker] to select a product for him/her/them.”²¹⁶

The effect of this paragraph is to continue the liberal model of contract formation that permits a mortgage broker to exploit power and information asymmetries. It leaves the prospective borrower in a defensive position and, despite the prescribed disclaimer, prone to relying on and deferring to the mortgage broker’s expertise and recommendations. The best that can be said of this part of the Agreement is that it performs a disclosure function. However, mortgage brokers have many tactics for minimizing the impact of this or any other disclosure, including marginalizing the content of the disclosure (“it’s just standard language”) and depriving the borrower of the opportunity to read and appreciate the disclosure (“just sign here so we can get on to finding a loan for you”).²¹⁷ As two authors aptly indicated, disclosure is just caveat emptor wrapped up in a fancy brochure.²¹⁸ The Agreement puts the onus on the innocent consumer to protect him or herself instead of changing the predatory behavior of the broker.

Paragraph three requires a mortgage broker to disclose the “maximum fee” charged for arranging the loan and the amount of the application fee the borrower must pay.²¹⁹ This paragraph acknowledges that fees for “other services” will be charged, but the broker does not have to identify the services or provide fee amounts. Presumably, these are fees to third-party service providers and will be anticipated in the Good Faith Estimate (GFE) required by the Truth in Lending Act²²⁰ and identified on the closing settlement statement required by the Real Estate Settlement Procedures Act.²²¹ The shortcomings of the GFE and the settlement

214. *Id.*

215. *Id.*

216. *Id.* Slashes appear in the original and address subject-verb agreement and inclusive language.

217. For a more detailed discussion of techniques a mortgage broker can use to obfuscate the meaning of “disclosed” information, see Wilson, *supra* note 5, at 1493, 1500–02.

218. Engel & McCoy, *supra* note 177, at 1311.

219. Regulation B-96-1, *supra* note 211, app.

220. 15 U.S.C. §§ 1601–1667 (2000).

221. 12 U.S.C. §§ 2601–2616 (2000).

statement as disclosure tools have been identified,²²² and paragraph three of Vermont's prescribed contract does nothing to improve a borrower's understanding of fees he or she will pay for "other services." Finally, this paragraph requires the broker to state whether the fees "will/will not be refunded,"²²³ but no conditions for refunding are identified.

Paragraph four appears to require disclosure of yield-spread premiums (YSP).²²⁴ Unfortunately, the wording of the contract renders it less effective than consumers would hope. This paragraph states, "[Mortgage broker] will be receiving a fee or other compensation from the lender for arranging this loan. The fee will not be more than ___% of the loan amount."²²⁵ The fee the broker will receive from a lender is a YSP. It is valuable to identify clearly just what a YSP is. It is a bounty that a lender pays to a mortgage broker as a reward for convincing a borrower to agree to pay an interest rate greater than the rate the lender has previously determined to be acceptable (the par rate) based on the borrower's risk of default as measured by his or her credit score. In other words, YSPs reward the broker for steering a borrower to an unnecessarily high interest rate. For that reason, YSPs reward a broker for engaging in opportunistic loan pricing instead of risk-based pricing.²²⁶

One objectionable feature of YSPs is that they exploit information asymmetry, as the lender and the broker know the par rate but the borrower does not. This imbalance in information enables the broker to prey on the borrower's lack of information to drive up the cost of the loan. In effect, the borrower ends up paying the YSP in the form of additional interest over the life of the loan. Paragraph four of the Vermont statute attempts to correct this information asymmetry, but it is not successful.

One deficiency in paragraph four relates to the ease with which a broker can "spin" the words of the disclosure. Although the contract form requires the broker to clearly state the maximum amount of additional compensation the broker will receive, the disclosure is phrased in a way that creates the appearance that this compensation will come "from the lender." This statement is correct only in a hyper-technical and legalistic sense. In truth, the YSP payment originates with, and is wholly dependent upon, the borrower's payment of an artificially high interest rate. The Vermont statute does not achieve its disclosure goal because it does not require the broker to reveal the mechanism by which the "other compensation" is generated. As the disclosure is currently written, a borrower's reaction could be, "Because the 'other compensation' is coming from the lender, it doesn't really concern me." If the YSP process were fully disclosed, that reaction would likely be replaced with, "Why are you trying to profit by coercing me to take out a loan with a higher interest rate than the lender has already agreed to?" YSPs should be prohibited. If, however, YSPs are going to be permitted, they should at least be

222. For a discussion of the perceived shortcomings of the GFE and settlement statement, see Wilson, *supra* note 5, at 1498.

223. See Regulation B-96-1, *supra* note 211, app.

224. *Id.*

225. *Id.*

226. For a more detailed discussion of YSPs, see Wilson, *supra* note 5, at 1514-16.

identified in a manner that truly discloses their effect and source, thereby empowering the borrower-consumer to challenge them.

Although less than ideal, Vermont's contract model represents a plausible theoretical method for defining the mortgage broker-borrower relationship. However, this particular example fails to protect consumers' interests adequately. It is difficult to reconcile the content of Vermont's Broker/Prospective Borrower Agreement with the provisions of the licensing statute, which require clear and informative disclosures, recognize "a Mortgage Broker's obligation to represent the interests of the borrower,"²²⁷ and expressly prohibit "unconscionable conduct which takes advantage of a borrower's lack of bargaining power or lack of understanding of the terms or consequences of the transaction."²²⁸

B. The Optional Quasi-Agency Duty Model

Kentucky and Minnesota utilize a model in which a broker may assume, but is not required to assume, certain agency duties toward a borrower. Although these licensing statutes, like Vermont's statute, require the broker to memorialize in a contract the services to be provided,²²⁹ they go beyond the Vermont contract model by establishing certain agency duties for brokers. The Kentucky and Minnesota licensing statutes follow the same model; however, they contain notable differences. Those differences account for elevating Minnesota's statute above Kentucky's in the taxonomic hierarchy.

Kentucky's licensing statute represents an advance in consumer protection over the pure contract-based model as it authorizes an agency relationship with some attendant duties. In addition, if the broker chooses not to enter into an agency relationship, he or she must affirmatively disclaim the existence of duties to the borrower. Despite these provisions, the promise of section 294.270, which is titled "Mortgage loan broker as agent for individuals applying for mortgage loans; disclosure required,"²³⁰ is not realized.

Section 294.270 states, "A mortgage loan broker *may* act as agent for the person or persons, if an individual or individuals, attempting to obtain a mortgage loan."²³¹ This language is clearly permissive rather than mandatory. In the absence of a requirement that a broker act as an agent of the borrower, it is difficult to believe that an appreciable number of mortgage brokers in Kentucky will voluntarily take on agency duties, especially when those duties impose an elevated standard of conduct that is inconsistent with the exploitative tactics that predatory brokers employ.

On those presumably rare occasions where a broker agrees to act as an agent for a borrower, the Kentucky statute does not identify the duties that flow from the election. In states that have enacted statutory agency duties for real estate sales brokers, delineating the scope of the agency duties has been a matter of great

227. Regulation B-96-1, *supra* note 211, § 8.

228. VT. STAT. ANN. tit. 8, § 2210(a)(3) (2001).

229. See KY. REV. STAT. ANN. § 294.120(7) (West Supp. 2005); MINN. STAT. ANN. § 58.13, subd. 2 (West Supp. 2006).

230. KY. REV. STAT. ANN. § 294.270.

231. *Id.* (emphasis added).

concern and attention, for both the real estate sales broker and the consumer.²³² A desire to provide certainty for both parties and to help balance sales brokers' and buyers' interests produced statutory provisions that specifically identify the duties imposed, the procedure for creating and terminating the agency relationship, and the relationship of the statutory duties to common law agency principles.²³³ All of these issues are left unresolved in Kentucky's licensing statute, which provides regrettably little guidance to consumers, or to brokers for that matter.²³⁴

If Kentucky's statute serves any consumer protection purpose, it is to compel the mortgage broker to make a disclosure about his or her relationship with the borrower. Section 294.270 provides:

The mortgage loan broker shall clearly and conspicuously disclose to the person or persons attempting to obtain a mortgage loan *whether* the mortgage loan broker is acting as an agent for that person or persons, in a separate writing, and provide such disclosure...before any personal financial information may be obtained by the mortgage loan broker.²³⁵

The clarity and timing requirements stated here are laudable, but the effectiveness of disclosure as a consumer protection device is always suspect. As stated above, there are many tricks a broker can use to eviscerate the usefulness of the disclosure to the borrower-consumer.²³⁶ The statute is further insufficient as it does not inform the consumer about the legal effect of the acceptance or rejection of an agency relationship. A disclosure that does not explain the available options and legal consequences does not empower the consumer to bargain effectively or to make informed decisions.

Lastly, the treatment of YSPs under Kentucky's licensing statute merits special scrutiny. From the viewpoint of this Article, which is that YSPs cannot be justified because they encourage steering and opportunistic loan pricing, Kentucky's Mortgage Loan Broker Act embodies an incorrect policy decision. First, unlike paragraph four of Vermont's Broker-Prospective Borrower Agreement, Kentucky's statute does not require any specific disclosure that a YSP will be paid. The best the borrower-consumer can expect is that the YSP will be included in some form on the closing settlement statement. As has been noted elsewhere, such "disclosure" is often done in cryptic terms that the borrower may not understand, is often made for the first time at the closing table where there is significant pressure to close the deal quickly, and is made in a coercive context where the broker counts on the reluctance of an unsophisticated borrower to challenge the expertise of the broker, whom the borrower has been encouraged to trust.²³⁷ Disclosure under these circumstances is inadequate to be of any meaningful benefit to borrowers.

232. For a more detailed discussion of the adoption of agency duties for real estate brokers who represent buyers, see Wilson, *supra* note 5, at 1502-11.

233. *Id.*

234. For a detailed discussion of the adoption of a buyer's agency regime in Indiana, see Lloyd T. Wilson, Jr., *Reconstructing Property Law in Indiana: Altering Familiar Landscapes*, 33 IND. L. REV. 1405, 1419-31 (2000).

235. KY. REV. STAT. ANN. § 294.270 (emphasis added).

236. See *supra* note 217 and accompanying text.

237. See Wilson, *supra* note 5, at 1494.

A second and more troubling aspect of Kentucky's statute is that it gives express institutional approval to YSPs. The administrative regulations that implement the Mortgage Loan Broker Act are clear and direct on this point: "The following fees may be paid by the lender... (b) [y]ield spread premiums to loan companies and brokers."²³⁸ Indeed, the tenor of both the Act and the corresponding regulations tends to validate charges that brokers and lenders can compel borrowers to pay, rather than protecting them from unfair charges.²³⁹

In sum, Kentucky's statute authorizes an agency relationship between the mortgage broker and the borrower but does not impose any duties unless the broker voluntarily assumes them. It is unfortunate from a consumer's standpoint that the statute utilizes an opt-in procedure. The statute provides no incentive for a broker to create an agency relationship and instead provides guidance for disclaiming any agency obligations. Even if a broker were to agree to act as an agent for a borrower, the statute does little to identify the legal ramifications of that choice for either the borrower or the broker.

Minnesota's Residential Mortgage Originator and Servicer Licensing Act makes several improvements to Kentucky's approach. First, Minnesota imposes certain statutory duties on mortgage brokers apart from any negotiation between a broker and a borrower. Among these obligations is a duty to account for all funds received in connection with a residential mortgage loan²⁴⁰ and a duty to segregate trust account funds from the broker's own funds.²⁴¹

Perhaps the most interesting of the universally applicable duties imposed by the Minnesota licensing act is found in section 58.13(18), which states that a mortgage broker shall not

make, provide, or arrange for a residential mortgage loan that is of a lower investment grade if the borrower's credit score... indicates that the borrower may qualify for a residential mortgage loan... that is of a higher investment grade, unless the borrower is informed that the borrower may qualify for a higher investment grade loan with a lower interest rate and/or lower discount points, and consents in writing to the receipt of the lower investment grade loan.²⁴²

This paragraph expressly prohibits the predatory act of steering.²⁴³ This Article contends that the language can also be construed to require disclosure to and written consent by the borrower before a YSP can be collected. Because a borrower who

238. 808 KY. ADMIN. REGS. 12:050(2)(2) (2006).

239. That the Kentucky act tends toward the lender's and broker's perspectives rather than toward a consumer's perspective is seen in section 294.120, which provides that "[e]very mortgage loan company may require borrowers to pay all necessary and reasonable expenses incurred in connection with the... loans." KY. REV. STAT. ANN. § 294.120(1). If consumer protection were the focus of the statute, one would expect it to be written in terms of regulating lender and broker charges rather than authorizing them.

240. MINN. STAT. ANN. § 58.13, subdiv. 1 (West Supp. 2006).

241. *Id.* § 58.13, subdiv. 2.

242. *Id.* § 58.13, subdiv. 18.

243. Steering has been defined variously as "[t]he process by which loan brokers direct borrowers to lenders who will provide high-cost loans, even though the borrowers would qualify for much lower interest rates," Kurt Eggert, *Lashed to the Mast and Crying for Help: How Self-Limitation of Autonomy Can Protect Elders from Predatory Lending*, 36 LOY. L.A. L. REV. 693, 702 (2003), and as "the deliberate manipulation of a borrower to execute a promissory note that has a higher interest rate than warranted by [a borrower's] credit rating." Wilson, *supra* note 5, at 1478.

pays a YSP is charged a higher interest rate than the par rate the lender has determined is justified by the borrower's risk of default, the effect is functionally the same as if the borrower had been steered toward a lower investment grade loan. Coercing a borrower to pay a YSP results in an artificially inflated interest rate just as surely as steering.

The Minnesota licensing statute itself does not mention YSPs, but section 58.137, which limits the amount of a lender's fee that can be capitalized, is relevant. That section states, "A residential mortgage originator making or modifying a residential mortgage loan to a borrower located in this state must not include in the principal amount of any residential mortgage loan all or any portion of any lender fee in an aggregate amount exceeding five percent of the loan amount."²⁴⁴

In connection with that statute, a recent posting on the Minnesota Department of Commerce website contained the following "frequently asked question": "Is a yield spread premium payable by a lender to a residential mortgage originator included in the 5 percent cap [of section 58.137]?"²⁴⁵ The Commissioner's response was: "No, because it is not a fee paid directly by the borrower."²⁴⁶ Two conclusions can be drawn from this exchange. First, YSPs are permitted in Minnesota. Second, Minnesota has adopted a legalistic view of the source of the YSP. The key word in the Commissioner's answer is "directly." It may be true that the YSP bounty is paid in the form of a check from the lender to the broker, but that fact misses the more important point that the YSP is really an upfront distribution to the broker of part of the excessive interest payments the borrower will make over the life of the loan.

The requirement that a broker disclose the act of steering (which should also include receipt of a YSP) and obtain a borrower's consent is an advance in consumer protection, but it could be improved. The requirement is flawed because the statute does not prescribe the form of the disclosure, other than to provide that it be in writing. Further, as with all disclosures intended to inform and empower a consumer, and thereby adversely affect a broker's ability to exploit asymmetries of information and power, there is the danger that the disclosure will be concealed or obfuscated. Finally, there are the related problems of ensuring that the borrower receives the disclosure timely and in a non-coercive context and is given a reasonable opportunity to understand the disclosure and its legal ramifications. The limitations inherent in placing the responsibility for making disclosures on the party whose self-interest is threatened by them should be apparent.

These deficiencies are augmented by the fact that missing from the disclosure requirement of subdivision one of section 58.137 are protective mechanisms such as the font size, dual reading, and three-day right of rescission protections Minnesota provides with regard to pre-payment penalties.²⁴⁷ When YSPs are

244. MINN. STAT. ANN. § 58.137, subd. 1.

245. FAQs—for Residential Mortgage Originators & Servicers, <http://www.state.mn.us/portal/mn/jsp/common/content/include/contentitem.jsp?contentid=536885485> (last visited Apr. 24, 2006). Subsequent to April 24, 2006, the Minnesota Department of Commerce revised its website, deleting this question and response. A hard copy of the former version of the FAQs is on file with the author.

246. *Id.*

247. *See* MINN. STAT. ANN. § 58.137, subd. 2 ("The residential mortgage originator shall read the disclosure to the prospective borrower when the prospective borrower requests a residential mortgage loan, and again within three days before the borrower signs the note or other agreement for the residential mortgage loan.").

capitalized into the principal amount of the loan, they strip equity from a borrower just as surely as pre-payment penalties. When the YSP is not capitalized and is paid out of the borrower's pocket, it is merely another form of wealth that gets stripped. There is no principled reason to give preferential treatment to YSPs over pre-payment penalties.

The advance achieved by Minnesota's licensing statute is that an agency relationship is established in at least two limited circumstances—when the mortgage broker accepts an advance fee from the borrower or when the broker offers to act as the borrower's agent in locating a loan.²⁴⁸ In either of these situations, the mortgage broker "shall be considered to have created a fiduciary relationship with the borrower and shall comply with the requirements of subdivisions 2 to 7."²⁴⁹ In all other situations, the parties are free to bargain solely with regard to their self-interests and are "free" to protect themselves.

If the broker's duties are to be optional, the state should seek to ensure that the borrower-consumer understands the legal nature of his or her relationship with the broker and is given the tools needed to make an informed choice. Minnesota attempts to achieve these goals by imposing the use of either a non-agency disclosure or, if a broker accepts an advance fee or offers to act as the borrower's agent, the use of a contract that includes specific terms. The requirement that non-agency status be disclosed is contained in subdivision 1 of section 58.15, which provides, "If a residential mortgage originator...does not offer to contract to act as an agent of the borrower, or accept an advance fee, it must, within three business days of accepting an application for a residential mortgage loan, provide the borrower with a written disclosure...."²⁵⁰

Form and content requirements for the disclosure are also provided:

The disclosure must be a separate document, 8-1/2 inches by 11 inches, must be signed by the borrower and must contain the following statement in 14-point boldface print:

Originator IS NOT ACTING AS YOUR AGENT IN CONNECTION WITH OBTAINING A RESIDENTIAL MORTGAGE LOAN. WHILE WE SEEK TO ASSIST YOU IN MEETING YOUR FINANCIAL NEEDS, WE CANNOT GUARANTEE THE LOWEST OR BEST TERMS AVAILABLE IN THE MARKET.²⁵¹

This disclosure process has several shortcomings. First, the timing of the disclosure in relation to the borrower's submission of a loan application is far from optimal. If the purpose of disclosure is to ensure that the borrower enters into discussions with a broker with a correct and clear view of their relationship, the non-agency disclosure should be required at the point they commence specific discussions about a loan. Section 58.15 permits a broker to delay making the

248. See *id.* § 58.16, subd. 1 (West 2002).

249. *Id.* Subdivisions 2 to 7 include requirements relating to broker-borrower contract (subdiv. 2), borrower's right of cancellation (subdiv. 3), broker's trust account (subdiv. 4), recordkeeping procedures for fees (subdiv. 5), monthly statement of disbursements (subdiv. 6), and disclosure of lenders to whom a loan application was submitted (subdiv. 7).

250. *Id.* § 58.15, subd. 1.

251. *Id.* § 58.15, subd. 2.

required disclosure of non-agency until just prior to the expiration of the three-day right of rescission provided by the Truth in Lending Act. Because a borrower is less likely to rescind the longer he or she has been psychologically committed to the loan, delaying the non-agency disclosure is likely to deprive it of the desired goal of ensuring that the borrower understands the broker is not the borrower's agent.

Second, although the separate document, borrower signature, and bold-face type requirements promote consumer protection, the content of the disclosure is insufficient to meet consumers' needs. The disclosure is inadequate because it does not tell consumers that the choice of an agency relationship is available, nor does it tell consumers the legal ramifications of non-agency versus agency relationships. In the absence of that information, which is also missing in the Kentucky statute, a consumer cannot make an informed choice or bargain for a better deal.

Third, the language does not sufficiently sound an alarm about the risks of opportunistic activity by a broker. Initially, the disclosure reinforces the borrower's predisposition to trust and to rely on the broker. There is a risk that the introductory phrase, "WE SEEK TO ASSIST YOU IN YOUR FINANCIAL NEEDS" will overshadow the warning message that "WE CANNOT GUARANTEE THE LOWEST OR BEST TERMS AVAILABLE IN THE MARKET."²⁵² Even that warning is tepid and fails to inform the borrower that the broker may recommend a loan that suits the broker's needs more than the borrower's. A borrower could read those words and think, "There are so many lenders and options out there, of course my broker can't guarantee that he will find the absolute best one." The use of the superlatives "lowest" and "best" allow the borrower to think, likely with broker encouragement, that the broker will still find a deal that is in the borrower's interest. Suitability, not superlatives, should be the focus.

The alternative in Minnesota to the disclosure of non-agency is a written contract in which the broker agrees to act as the borrower's agent. If a broker solicits or collects an advance fee or if the broker agrees to act as an agent of the borrower, Minnesota's statute requires a written contract between the broker and the borrower.²⁵³ This contract must be executed "at or before the time of receipt of any fee or valuable consideration paid for mortgage origination services."²⁵⁴ Minnesota's statute describes the content of the contract in general terms and, unfortunately, leaves the specific wording of the contract to the parties. The scope and content of the "fiduciary relationship"²⁵⁵ that the statute says arises from accepting an advance fee or consenting to act as agent of the borrower are, apart from the hints given in section 58.16, nowhere identified. The absence of prescribed form and content allow the broker to craft the contract to his or her advantage.

The heart of such a contract should be for the broker to inform the borrower of the services the broker will and will not perform with regard to the loan transaction and the duties the broker owes as the buyer's agent. The Minnesota statute directs the broker to "specifically describe the services to be provided,"²⁵⁶ but then provides

252. *Id.*

253. *Id.* § 58.16, subdiv. 2(a) (West Supp. 2006).

254. *Id.*

255. *Id.* § 58.16, subdiv. 1.

256. *Id.* § 58.16, subdiv. 2(a)(1).

no guidance for judging what qualifies as “specific description.” The statute also directs the broker to “specifically identify whether [the broker] may receive compensation from sources other than the borrower.”²⁵⁷ As with the Kentucky statute, no specific reference to YSPs is required, and the phrase “compensation from sources other than the borrower” masks the fact that the borrower is the true source of the compensation. As a result, the borrower unknowingly agrees to pay an unnecessarily high interest rate.

A second important component of the agency contract is a three-day right of rescission. This right is both unconditional and non-waivable and need not take any particular form.²⁵⁸ It is sufficient if the borrower “indicates by any form of written expression the intention...not to be bound by the contract.”²⁵⁹ This right gives the borrower an opportunity to reconsider an agreement that may have been executed due to the coercive presence of the broker. It also permits additional comparison shopping. This rescission right is crafted to protect the consumer and should be emulated.

Minnesota’s statute points in the right direction—fiduciary duties for the broker based on an agency relationship—but the statute suffers from a lack of specificity. It also provides limited protection to consumers because agency duties are, for the most part, optional. With the disclaimer of affirmative duties so easily achieved under the statute, the default position is likely maintenance of the status quo, where each party is left to bargain for the highest level of individual utility and to defend against the other’s efforts to secure the same end. Moving beyond the status quo requires making the agency relationship mandatory instead of optional. North Carolina’s use of mandatory broker duties is the next model in the taxonomy.

C. *The Mandatory Quasi-Agency Duty Model*

North Carolina’s Mortgage Lending Act utilizes a broker regulation model based on statutorily imposed duties rather than an optional assent-based model. In fact, neither the Act nor the implementing regulations contain any reference to a contract requiring the assent of the broker and the borrower. Instead, the duties imposed in the statute arise automatically by virtue of the parties’ relationship as broker and borrower. The statutory duty model of the Mortgage Lending Act offers several advantages over the contract model. At the same time, North Carolina’s statutory duty model is not fully developed.

Section 53-243.10 provides:

A mortgage broker...shall, in addition to duties imposed by other statutes or at common law:

- (1) Safeguard and account for any money handled for the borrower;
- (2) Follow reasonable and lawful instructions from the borrower;
- (3) Act with reasonable skill, care, and diligence; and
- (4) Make reasonable efforts, with lenders with whom the broker regularly does business to secure a loan that is reasonably advantageous to the borrower

257. *Id.* § 58.16, subdiv. 2(a)(2).

258. *Id.* § 58.16, subdiv. 3.

259. *Id.*

considering all the circumstances, including the rates, charges, and repayment terms of the loan and the loan options for which the borrower qualifies with such lenders.²⁶⁰

The most striking feature of section 243.10 is that it restates the duties that characterize an agency relationship under common law. Parallel provisions to the duty to account of section 243.10(1), the duty to follow instructions of section 243.10(2), and the duty to act with reasonable skill, care, and diligence of section 243.10(3) are found in the *Restatement (Second) of Agency* at sections 382, 385, and 379, respectively.²⁶¹

In addition, section 243.10(4) of the Mortgage Lending Act imposes a suitability requirement on mortgage brokers that is analogous to the duty of loyalty found in section 387 of the *Restatement (Second) of Agency*.²⁶² The requirement in the statute that a broker secure a loan that is reasonably advantageous to the borrower (even if that loan is less advantageous than another to the broker) echoes the *Restatement's* requirement in section 387 that "an agent is subject to a duty to [the] principal to act solely for the benefit of the principal."²⁶³ The suitability requirement in the statute at section 243.10(4) imposes a duty on the agent to subordinate his or her interests to those of the principal, similar to the traditional agency duty of loyalty.

Although the statute specifically identifies "rates, charges, and repayment terms of the loan and...loan options"²⁶⁴ as factors to be considered in determining suitability, there is no indication that the statute intends this list to be exclusive or to limit the core requirement that the loan be suitable to the borrower. To consider "all the circumstances," a broker must obtain specific information about each applicant concerning such things as employment type and history, formal and informal financial obligations that impact the borrower's ability to pay and borrowing or refinancing history. Only by asking will a broker know how long the borrower intends to remain in his or her house, whether a borrower's employment is stable, or whether the borrower provides financial support to adult children or extended family members—to name only three factors a broker would have to consider to determine that a loan is suitable under "all the circumstances." In the absence of a suitability requirement, a broker could easily ignore these facts in the interest of closing a loan and earning a fee, but any loan arranged by a broker that does not consider "all the circumstances" cannot be "reasonably advantageous" and, therefore, fails to satisfy North Carolina's statutory suitability requirement.²⁶⁵

A statutory agency model has several advantages over an optional agency model. First, the mortgage broker's duties to the borrower are automatic and mandatory.

260. N.C. GEN. STAT. ANN. § 53-243.10 (West, Westlaw through 2005 Reg. Sess.).

261. See *supra* notes 197–200 and accompanying text.

262. RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

263. *Id.*

264. N.C. GEN. STAT. ANN. § 53-243.10(4).

265. A parallel suitability requirement is present in North Carolina's high-cost loan statute, which states that a mortgage broker is prohibited from recommending a refinance of an existing loan unless the refinance results in a "reasonable, tangible net benefit to the borrower." *Id.* § 24-1.1E (West 1999). For a more detailed discussion of suitability requirements in anti-predatory lending legislation, see Engel & McCoy, *supra* note 177, at 1317–66, and Wilson, *supra* note 5, at 1520–23.

They do not depend on either assent of the broker or bargaining by the borrower. This fact is significant because the borrower may not know bargaining is possible or understand the advantages to be gained. Second, by not depending on a written contract, statutory duties negate a broker's ability to manipulate the contract's form and content. The statutory duties of the Mortgage Lending Act are superior to a general and unguided requirement that the contract "specifically describe the services to be provided."²⁶⁶ Third, because there is no document, the Act avoids broker manipulation of the context in which options are presented to the borrower. As a result, the broker loses the ability to capitalize on a coercive environment and on the borrower's own decision making heuristics.²⁶⁷ Fourth, the statutory duties contained in section 243.10 likely match the borrower's assumptions about the nature of his or her relationship with the broker as one where the broker works *for* the borrower as well as works *with* him or her.²⁶⁸ Finally, by compelling mortgage brokers to meet elevated standards of behavior instead of merely forbidding egregious actions, the Act channels broker conduct toward responsible and socially acceptable behavior.

Despite the advance represented by the North Carolina Mortgage Lending Act, it also has some omissions that render it a partial, rather than complete, expression of an agency regime. First, the Act never specifically uses the words "agent," "principal," or "agency" to describe the relationship between mortgage brokers and borrowers. The reader is left to infer that relationship from the language of section 243.10 and its similarity to sections of the *Restatement (Second) of Agency*. The statute should simply say what it does.

Second, although the Act creates broker duties (and corresponding borrower rights) that are typical of an agency relationship, it omits other provisions typically found in an agency regime. For example, the Act does not specifically identify when the automatic agency relationship begins or how the agency relationship can be terminated; nor does the Act identify which duties survive termination.²⁶⁹

Third, consumer protection would be increased by requiring brokers to inform borrowers about the scope and nature of the agency duties. This goal could be accomplished via a state-prescribed form to be given to the borrower at the inception of the relationship (which points out the need to specifically identify the time at which the duties arise).²⁷⁰ Concerns about the ineffectiveness of disclosures, while perhaps not eliminated, are greatly reduced by the fact that the agency duties are obligatory and will be applied in any event. With no way to evade the duties, a

266. MINN. STAT. ANN. § 58.16(2)(1) (West Supp. 2006); see also VT. STAT. ANN. tit. 8, § 2219 (2001) ("The agreement shall set forth the particulars of the services to be performed by the mortgage broker....").

267. For a discussion of the heuristics that affect a borrower's decision making, see Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Lending*, 69 TUL. L. REV. 373, 384-86 (1994).

268. See Wilson, *supra* note 5, at 1522.

269. See, e.g., RESTATEMENT (SECOND) OF AGENCY §§ 26-27 (1958) (creation of a relationship); *id.* §§ 105-119 (termination of a relationship); *id.* § 396 (the duty of confidentiality survives termination of a relationship).

270. A state-prescribed form explaining the relationship options would avoid that criticism, as well as other problems associated with leaving document preparation to brokers who are inclined toward predatory acts.

broker would have little incentive to conceal or obfuscate, an act itself that would violate the agency relationship.

Fourth, the Mortgage Lending Act states that the statutorily imposed duties are "in addition to duties imposed...at common law."²⁷¹ This provision raises an important question: Should the statutory agency duties be exclusive or supplementary? The real estate sales profession encountered this issue in the 1990s when the National Association of Realtors abandoned mandatory sub-agency and authorized borrower's agency. In the real estate sales brokerage context, states enacted statutes that took one of three paths. Some statutes did not address the issue at all. This is the least satisfactory solution because it provides no guidance to courts and does nothing to further certainty and predictability for either real estate brokers or buyer-consumers. Other states took the approach used by North Carolina in the Mortgage Lending Act, which is to have statutory duties supplemented by the common law. Still other states determined that the statutory agency duties should be exclusive and supersede the common law.²⁷²

Choosing between a supplementary and an exclusive approach involves balancing the goals of protecting consumers with the goal of providing specific guidance to mortgage brokers about behaviors that are required, permitted, and prohibited so that they can conform their behavior to the desired norm. The supplementation model may appear to provide the greater degree of consumer protection as it creates new legal duties for brokers without affecting other duties that may also apply. One weakness of the supplementary model is that it can result in statutory duties that are incompletely stated precisely because the common law continues to apply. This result is undesirable for consumers because imprecision impedes the goal of enunciating clear standards for broker behavior. The goal of compelling mortgage brokers to conform their behavior to desirable norms may best be achieved by enacting exclusive, but comprehensive, agency duties within a systematic statutory agency regime.

An exclusive approach to statutory agency duties could also simplify proof issues in legal claims against brokers, making it easier for wronged consumers to establish their claims. The elements of a cause of action for violating the broker's duties to the consumer would be found in the statute. Consumers' interests can be protected by a statutory formulation of broker duties that incorporates the best features of the common law and also tailors those duties to the context of mortgage brokering and to the specific needs of consumer-borrowers. However, if a state is unwilling to expend the effort needed to create a comprehensive agency regime for mortgage brokers, common law agency principles must remain available as a safety net for consumers.

IV. CONCLUSION

Mortgage broker licensing statutes can be an important component of a systematic approach to combating predatory lending. To protect consumers, states should build on the best features of licensing statutes enacted throughout the

271. N.C. GEN. STAT. ANN. § 53-243.10 (West, Westlaw through 2005 Regular Sess.).

272. For a more detailed discussion of this topic, see Wilson, *supra* note 5, at 1510 n.203.

country to produce a statute that effectively carries out each component of the gatekeeping and administrative oversight functions and defines the nature of the broker-borrower relationship according to a statutory agency regime. The gatekeeping function will exclude from the mortgage brokering industry those persons who pose a risk to consumers and will license only those persons who possess adequate knowledge about mortgage lending products and procedures. The administrative oversight function will ensure that those persons who obtain licenses continue to act responsibly, will sanction those brokers who engage in predatory acts, and will provide compensation for their victims. Defining the broker-borrower relationship through statutory agency duties will bring the law into alignment with borrower expectations, will provide a clear statement of expected broker practices, and could channel many mortgage brokers away from predatory behavior.