

MINUTES OF THE MEETING
OF THE
LEGISLATIVE COMMISSION'S SUBCOMMITTEE TO
INVESTIGATE REGULATION OF MORTGAGE INVESTMENTS

August 24, 1998

Las Vegas, Nevada

The second meeting of the Legislative Commission's Subcommittee to Investigate Regulation of Mortgage Investments for the 1997-1998 interim was held on Monday, August 24, 1998, at 8 a.m., in Room 4401 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada. This meeting was video conferenced to Room 1214 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. Pages 2 and 3 contain the "Meeting Notice and Agenda."

SUBCOMMITTEE MEMBERS PRESENT:

Assemblyman David E. Goldwater, Chairman

Senator Bill R. O'Donnell

Senator Raymond C. Shaffer

Assemblyman Tom Collins

Assemblywoman Barbara K. Cegavske

SUBCOMMITTEE MEMBER ABSENT:

Senator Randolph J. Townsend

LEGISLATIVE COUNSEL BUREAU (LCB) STAFF PRESENT:

Vance A. Hughey, Senior Research Analyst

Kimberly A. Morgan, Chief Deputy Legislative Counsel

Kevin C. Powers, Deputy Legislative Counsel

Ricka Benum, Senior Research Secretary

REVISED

MEETING NOTICE AND AGENDA

Name of Organization: Legislative Commission's Subcommittee to

Investigate Regulation of Mortgage Investments

Date and Time of Meeting: Monday, August 24, 1998

8 a.m.

Place of Meeting: Grant Sawyer State Office Building

Room 4401

555 East Washington Avenue

Las Vegas, Nevada

Note: Some members of the committee may be attending the meeting, and other persons may observe the meeting and provide testimony, through a simultaneous video conference conducted at the following location:

Legislative Building

Room 1214

401 South Carson Street

Carson City, Nevada

A G E N D A

I. Opening Remarks and Introductions by the Chairman

Assemblyman David E. Goldwater

*II. Approval of the Minutes from the Subcommittee's First Meeting held June 30, 1998, in Las Vegas, Nevada

III. Overview of Mortgage Investment Industry Functions

Jerilyn J. Clayton, former Owner, Consolidated Mortgage Corporation, Las Vegas

IV. Response to Inquiries and Questions from Members of the Subcommittee Regarding the Procedures Implemented in the Handling of the Harley L. Harmon Mortgage Company Case

Douglas E. Walther, Senior Deputy Attorney General, Office of the Attorney General

V. Overview of Issues and Problems of the Credit and Loan Industry

Michele Johnson, President, Consumer Credit Counseling Service of Southern Nevada

VI. Remarks from Persons Involved in the Mortgage Investment Industry in Nevada

*VII. Discussion of Possible Recommendations for Future Legislation

VIII. Public Testimony

IX. Adjournment

*Denotes items on which the subcommittee may take action.

Note: We are pleased to make reasonable accommodations for members of the public who are disabled and wish to attend the meeting. If special arrangements for the meeting are necessary, please notify the Research Division of the Legislative Counsel Bureau, in writing, at the Legislative Building, 401 South Carson Street, Carson City, Nevada 89701-4747, or call Ricka Benum, at 684-6825, as soon as possible.

Notice of this meeting was posted in the following Carson City, Nevada, locations: Blasdel Building, 209 East Musser Street; Capitol Press Corps, Basement, Capitol Building; Carson City Courthouse, 198 North Carson Street; Legislative Building, Room 1214, 401 South Carson Street; and Nevada State Library, 100 Stewart Street. Notice of this meeting was faxed for posting to the following Las Vegas, Nevada, locations: Clark County Office, 500 South Grand Central Parkway; and Grant Sawyer State Office Building, 555 East Washington Avenue.

OPENING REMARKS AND INTRODUCTIONS BY THE CHAIRMAN

Chairman David E. Goldwater called the meeting to order. He recapped the subcommittee's first hearing explaining that many concerns were discussed which pertain to the regulatory environment of the mortgage investment industry. The Chairman indicated that the subcommittee's focus would be to gain a better understanding of the industry and to address the regulatory procedures which have been the subject of criticism from investors.

Opening the meeting with Agenda Item III, the Chairman emphasized the importance for the members to understand proper management procedures associated with the business of mortgage investments.

OVERVIEW OF MORTGAGE INVESTMENT INDUSTRY FUNCTIONS

Jerilyn J. Clayton

Ms. Clayton, former Owner, Consolidated Mortgage Corporation, Las Vegas, expressed concern with the recent incidents and current problems which have surfaced in the mortgage investment industry. She explained that during the early 1980s there were several failures of investment businesses when the state experienced extensive growth in the real estate market. These collapses were attributed to either: (1) economy fluctuation; (2) insufficient enforcement laws; or (3) a lack of effective regulations. During that time, Ms. Clayton was involved in the review of the laws and regulations and assisted in compiling the recommendations used to draft the major statutory changes that were implemented.

During her presentation, Ms. Clayton highlighted key issues contained in the document titled, "Investing in Trust Deeds." (Please refer to Exhibit A for details.) Alluding to the function of a mortgage broker and the services provided, she explained that:

- A mortgage broker arranges loans by bringing together borrowers and investors and charges a fee for this service. There are several types of mortgage brokers and many are termed "full-service brokers" since they collect funds as well as service investment loans.
- Borrowers who utilize the services of a mortgage broker include builders, developers, and home or land owners.
- Corporations, defined benefit group plans, individuals looking for high returns, pension or profit sharing plans, and self-directed individual retirement accounts (IRAs) are examples of investors who may employ a mortgage broker.
- Economic decline and market conditions may affect the stability of all trust deed loans, not just those arranged by a mortgage broker. The risk of bankruptcies, defaults, and foreclosure proceedings are also potential factors that may affect the certainty of investments.
- The primary procedures that should be required of mortgage brokerage businesses include: (1) adhering to regulation guidelines that stipulate certain methods of disclosure; (2) a disclosure requirement which emphasizes that an investment in a trust deed holds no guarantee for return; and (3) a statement of disclosure to the investor stressing the need to investigate the investment potential and the subject property.

- With each trust deed undertaking the investor should:
 1. Require a written appraisal or valuation of the investment property;
 2. Investigate any equity in the investment property and the borrower's ability to repay the loan;
 3. Refuse any dissolution of equity; and
 4. Require written receipts and proper loan documentation including a: (a) copy of the executed Note; (b) conformed copy of the [recorded] Deed of Trust; and (c) title insurance policy naming the investor's undivided beneficial interest.

Ms. Clayton offered the following suggestions for inclusion or revisions to current *Nevada Revised Statutes* (NRS) or policies set forth under the *Nevada Administrative Code* (NAC). She recommended that:

1. Mortgage brokers be prohibited from guaranteeing the payment of interest or principal amounts of a loan.
2. The statutes include a provision stating that all monetary return on investments must come solely from the borrower's equity in the subject property, or the borrower's funds.
3. Administrative and oversight agencies be given the authority to increase the amount of fines for offenses, and implement such fines and/or punitive alternatives for industry violations, improper licensing applications, or conducting business without a mortgage business license.
4. Additional funds be allocated for regulatory agencies of the mortgage investment industry for the purpose of increasing staff within the Division of Financial Institutions, Nevada's Department of Business and Industry.
5. The division implement stronger regulatory authority for the enforcement of current statutes to eliminate other types of businesses, i.e. escrow or title companies, from operating at the same location as mortgage brokerage firms.
6. Additional requirements be incorporated in the existing law for extensive background investigations, character, and reference checks of applicants for mortgage brokers licenses.

A brief discussion ensued following questions from subcommittee members to Ms. Clayton. In addition to other issues, the dialogue focused on: (1) the importance of independent appraisals; (2) the statutory provision allowing an investor to refuse an appraisal; and (3) alternative methods of generating revenue to increase the staff of regulatory agencies for the purpose of increasing enforcement.

Ms. Clayton emphasized that limits should not be placed on the number of services mortgage brokers are allowed to provide their clients.

At the request of Senator Shaffer, Ms. Clayton agreed to provide the subcommittee with a copy of the document titled "Loan Servicing Agreement." (Please refer to Exhibit B.)

Chairman Goldwater announced that all suggestions or recommendations be submitted to staff prior to the subcommittee's next hearing to allow for the necessary preparation of a work session document.

APPROVAL OF THE MINUTES FROM THE SUBCOMMITTEE'S

FIRST MEETING HELD JUNE 30, 1998, IN LAS VEGAS, NEVADA

SENATOR O'DONNELL MOVED FOR APPROVAL OF THE MINUTES OF THE JUNE 30, 1998, MEETING OF THE LEGISLATIVE COMMISSION'S SUBCOMMITTEE TO INVESTIGATE THE REGULATION OF MORTGAGE INVESTMENTS, HELD IN LAS VEGAS. THE MOTION WAS SECONDED BY ASSEMBLYWOMAN CEGAVSKE AND PASSED UNANIMOUSLY.

The Chairman announced his intent to accommodate the schedules of the speakers to avoid time constraints and opened the meeting to the public testimony portion of the agenda. He requested an update on the status of the receivership of the Harley L. Harmon Mortgage Company.

PUBLIC TESTIMONY

Bernie Chippoletti

Mr. Chippoletti, the court-appointed receiver of the Harley L. Harmon Mortgage Company, provided an overview of the role and progress of the receivership pertaining to the Harmon case. He indicated that many challenges and difficulties have been incurred since taking over the operations of the mortgage company.

The following is a summary of the circumstances which have transpired under the administration of the receivership.

- In December 1997, Mr. Chippoletti was notified that he had been recommended by persons within the Division of Financial Institutions, to serve as receiver for the Harley L. Harmon Mortgage Company, and was subsequently appointed by Judge Stephen L. Huffaker, Eighth Judicial District, Las Vegas.
- On December 17, 1997, a meeting was held with Mr. Harmon at the offices of the mortgage company and files were reviewed. At the conclusion of the meeting, several boxes of "active mortgage files" were acquired and taken into possession by the receiver.
- The files provided were in disarray and it was necessary to reorganize the inventory of records in order to gain an understanding of the entire portfolio and make a determination of: (1) the amount of each loan; (2) an accurate count as to the number of investors; and (3) the status of each loan.
- Inspections of the subject properties began on January 24, 1998, and are ongoing as necessary to determine the condition of each lot or parcel, and to assess the amount of work remaining for completion of construction. Nevada Title Company, Las Vegas, was contracted to facilitate clearing the titles for successful sale and eventual close of escrow. The understanding between the receiver and Nevada Title Company was that payment for services would be delayed until each individual parcel closes escrow. This arrangement demanded that the title company extend much of its resources in addition to waiting for payment.
- By February 13, 1998, two loans involving a retail shopping center secured by second and third trust deeds, were negotiated to successful settlement. When the loans were paid in full, the funds were subsequently released by order of Judge Huffaker.
- At the time the mortgage company went into receivership, there were several loans in default and it was determined that these loans were to be given priority. The first Notice of Default was recorded on March 18, 1998, which set in motion the foreclosure process on a convenience store in Las Vegas. It was noted that other parcels were encompassed under bankruptcy proceedings in the United States Bankruptcy Court, Nevada District, and handled separately from the receivership.
- By March 4, 1998, the first receiver's report was filed with the district court. The document outlined the status of each loan and included pertinent information compiled during the receivership. The first hearing was held on March 23, 1998, for the purpose of: (1) confirming the receiver's compensation package; (2) reviewing the receiver's report; and (3) responding to questions raised by the court regarding the contents of the report.
- The basic provisions of the compensation package were approved by the court and established that:
 1. The receiver is responsible for the administration of three types of classifications: (a) performing loans, those not in default; (b) nonperforming loans reclassified as performing; and (c) nonperforming loans.

2. Compensation for the receiver will be determined at a rate of 5 percent of the amount recuperated from liquidation of the nonperforming loans.
3. The receiver is responsible for the attorney fees he incurs in relation to the receivership.
4. The accountant assisting the receiver will be paid on a per hour basis, at the approved rate of \$60 per hour.

In response to an inquiry pertaining to the liquidation of the nonperforming loans, Mr. Chippoletti testified that although questionnaires were sent to each investor requesting information, he relied on the preliminary title reports for an accurate account of recorded documentation. He pointed out that no investors had come forward with a claim of unrecorded beneficial interest in any of the liquidated loans.

Upon receipt of the informational questionnaires completed by the investors, several discrepancies surfaced when the amounts indicated did not coincide with the beneficial interests shown on the preliminary title reports. The majority of the loans initially showed Harley L. Harmon as the sole beneficiary. The title reports established that many of the loans had hundreds of beneficial interest transfers, and that several investors were assigned inaccurate percentages of beneficial interest.

In his report to the court, Mr. Chippoletti recommended that: (1) investor funds be distributed to investors involved in loan projects with only one deed of trust, an identified beneficiary, and a substantiated beneficial interest; and (2) investments involving multiple loans be deemed all-inclusive, and the beneficial interest of the investors be determined as a pro rata portion of the total investment amount. He stated that Nevada's Attorney General suggested the concept of "pooling" several of the loans with conflicting or disparaging beneficial interest amounts. Mr. Chippoletti explained that the receiver is appointed by the Office of the Attorney General (AG), but essentially is employed by the court and must administer the funds as directed by the court.

Mr. Chippoletti further explained that as the process moved toward liquidating more of the loans, "town hall-type" meetings were held with the investors holding a beneficial interest in the subject loan to discuss possible solutions and provide direction as to the manner in which the debts would be settled. The discussions included statements of principal balance, accrued interest and penalties value of the property, and merits of the payoff proposal. Investors were able to participate in deciding the final course of action and they were given the opportunity to accept, reject, or counter offer the proposals.

Continuing, Mr. Chippoletti spoke on several issues which were resolved under the administration of receivership. He stated that:

- At the onset of the receivership, numerous legal actions were pending which affected or involved the Harley L. Harmon Mortgage Company case. The lawsuits were extended throughout several courts in Las Vegas, and it was necessary to file a request for consolidation to allow all the cases to be heard in one court. It was necessary for the originally assigned judges as well as the attorneys representing each party to agree to the consolidation. Ultimately, the issue was approved and heard by Judge Huffaker.
- Foreclosure proceedings have been initiated on several of the nonperforming loans. The first foreclosure was finalized in July 1998.
- A circumstance was reconciled by negotiating with officials from the City of North Las Vegas regarding an issue whereby cash was paid in lieu of bonds for off-site improvements on subject properties.
- A situation was rectified whereby a prospective buyer had been occupying a subdivision residence for more than a year. The receiver's investigation concluded that there was no record of a down payment, mortgage, or rent payments. Eventually the person was evicted and a sale was negotiated.
- County title searches and records filed with the Nevada's Office of the Secretary of State concluded that to date, there are 307 investors, 44 loans, and 26 properties being administered by the receiver. All defaulted loans are now in foreclosure.

- Funds and income from the performing loans of the mortgage company are being held in a separate account. The court will direct the receiver how to handle distribution of the funds during a hearing scheduled for September 8, 1998.
- Early in the administration of the mortgage company, the court directed the receiver to service the loans and approved a fee of \$7.50 per check.

In response to questions from Assemblyman Collins, Mr. Chippoletti stated that:

1. The title reports indicate that portions of the beneficial interest in a number of the loans were not used for investments purposes. Therefore, the mortgage company has retained a certain amount of the beneficial interest.
2. The funds controlled under the administration of the receivership will be disbursed only at the direction of the court.
3. Regarding funds which may be disbursed to Mr. Harmon through title action on unrelated property, any title company handling separate transactions would be legally obligated to issue funds payable to Mr. Harmon, should a beneficial interest exist.

Mr. Chippoletti noted that should the above situation arise he, as administrator of the receivership, would attempt to gain control of any funds disbursed to Mr. Harmon.

**RESPONSE TO INQUIRIES AND QUESTIONS FROM MEMBERS OF
THE SUBCOMMITTEE REGARDING THE PROCEDURES IMPLEMENTED
IN THE HANDLING OF THE HARLEY L. HARMON MORTGAGE COMPANY CASE**

Brooke Nielsen

Ms. Nielsen, Assistant Attorney General, Office of the Attorney General, spoke on behalf of Frankie Sue Del Papa, Nevada's Attorney General, to address questions from the subcommittee pertaining to the handling of the Harley L. Harmon Mortgage case. Ms. Nielsen relayed the concerns of the Attorney General to the recent problems which focus on the statutes which apply to the mortgage industry. She added that industry regulators are aware of the difficulties and personal pain caused to investors by such business failures.

Ms. Nielsen offered assistance to the subcommittee to gain an understanding of the policies and procedures of AG's office, and to make recommendations to improve the regulatory statutes.

Answering questions posed by Assemblywoman Cegavske, Ms. Nielsen stated that:

1. Under current statutes, and unlike the provisions of NRS which address insurance, securities, and telemarketing laws, the AG's office does not have direct enforcement authority and cannot impose fines for regulatory violations. Only the Division of Financial Institutions has the authority to impose fines for regulatory violations of mortgage industry laws or regulations.
2. The AG cannot independently conduct investigations or take action against a financial institution, but works in the capacity to act as counsel and legal advisor of the division.
3. The AG is given authority, at the request of the Division of Financial Institutions, to seek court injunctions against a mortgage company thought to have committed either regulatory or statutory violations.

Douglas E. Walther

Mr. Walther, Senior Deputy Attorney General, Office of the Attorney General, addressed a question from Assemblyman Collins which focused on reports that Mr. Harmon was involved in the selection of Mr. Chippoletti to administer the receivership of the Harley L. Harmon Mortgage Company. He explained that settlement negotiations began following the filing of the district court action by the Division of Financial Institutions and included Mr. Harmon's legal counsel. During the negotiations the established process of designating a receiver was followed. The process involves reviewing a list of suggested candidates, and discussing in detail the qualifications of each person listed. He testified that Mr. Chippoletti's name was submitted by Mr. Harmon's attorney but was considered in the same manner, and on an equal basis with the other the candidates. The decision was based on the qualifications required to effectively administer the types of transactions in which the mortgage company was involved. Mr. Chippoletti's background included:

- Experience in real estate development;
- Knowledge of the construction loan process; and
- Recommendations from several outside sources.

In addition, Mr. Chippoletti had the ability to: (1) inspect construction projects in various stages of completion; (2) offer an accurate and current assessment of value; and (3) develop a successful plan for liquidating the properties. Also, Mr. Chippoletti assured the Division of Financial Institutions that his previous relations with Mr. Harmon did not go outside the realm of professional contact.

Mr. Walther said that in order for the subcommittee to develop an understanding of the Harmon case, it is necessary to establish legal points of reference and clarify the sequence of events pertinent to the decisions that were made. He thanked the Chairman for the opportunity to outline of the role of the AG's office in the Harmon matter, and described the progression of his involvement.

- The Memorandum from Burns Baker, Deputy Commissioner, Division of Financial Institutions, dated February 21, 1997 (Exhibit C), outlined the findings of the draft examination performed on the Harley L. Harmon Mortgage Company files. The overall purpose of the audits or examinations performed by the division are to identify violations and alert the agency to potential problems to be resolved at its discretion. There are many issues that are technically considered to be violations that are settled by division staff and the company involved. These cases are not usually discussed with the Attorney General. Mr. Baker made his supervisor aware of the problems he perceived to be serious and, in turn, the Office of the AG was notified. It was noted that this is the normal procedure and was followed in accordance with agency policy.
- There were circumstances which surfaced during the initial examination that indicated potential areas of risk and elevated the level of concern of the examiners. These issues were evidenced in the division's working investigation documents. Investment problems included:
 1. Loans which appeared to be short-funded and unequal investment payoffs.
 2. Documents which evidenced several investments that were not 100 percent funded, as is customary.
 3. One specific loan in the amount of \$1 million that was disbursed to the borrower with an amount totaling only \$750,000.
 4. A number of the loans were in various stages of default and several loans were in foreclosure.
 5. Missing loan documents and inadequate record keeping procedures.
 6. Proceeds from second trust deed payoffs which were applied to builder accounts of unrelated properties to resolve situations of short cash flows.

Mr. Walther stated that many of the questionable practices would not be considered illegal if Mr. Harmon could substantiate that investor disclosure laws were followed and that investors had signed waivers of documentation. The

division's position was to fully investigate each aspect of each file and obtain solid evidence before taking any action against Mr. Harmon. Mr. Baker's memorandum served to alert the division of possible violations, but did not provide the evidence necessary to take immediate action. Further, Mr. Walther stated that although he concluded that violations had occurred and his concerns were not satisfied, he stood by his decision to consider the potential for harm that may have resulted if he had taken action prematurely.

- The division questioned Mr. Harmon on every potential violation noted in Mr. Baker's correspondence. Mr. Harmon's testimony portrayed a situation of economic problems and difficulty managing investments with a large number of investors that were not able to agree on many of the investment decisions. The transcripts of Mr. Harmon's testimony were considered public record and were available to the investors.

In reply to questions from the subcommittee, Mr. Walther addressed the following issues:

1. State law provides for the division to approve the advertising of mortgage companies. The usual procedure of this regulatory practice does not involve legal counsel and he was not consulted regarding advertising issues in the Harmon case.
2. The position of general counsel to the division does not function as a prosecutor other than taking legal action to enforce regulatory operations such as seeking injunctive relief, fines, revocations, or suspensions. It is not usual procedure for the division's counsel to handle general information telephone calls pertaining to the case in question.
3. The investors have the option to file criminal complaints against Mr. Harmon. Many of the investors obtained legal counsel and pursued criminal avenues during the early stages of the investigation of the mortgage company.

Chairman Goldwater pointed out that following the March 1997 hearing, the evidence as well as several documented violations appeared to be sufficient to proceed with punitive action. In response, Ms. Nielsen defended the position of the counsel and the division by stating that after the March 1997 hearing, there was "not the hard evidence needed to go into court" and successfully impose fines, revoke licences, or to uphold a suspensions. She added that the division must be conscientious to complete a prudent investigation before taking any enforcement action.

Following the first subcommittee meeting, questions were posed to Mr. Walther in a letter from Chairman Goldwater. (Please see Exhibit D.) The Chairman requested that Mr. Walther profile his response to each inquiry, as written in his return correspondence, dated August 21, 1998. (Please refer to Exhibit E for the complete text of Mr. Walther's written correspondence.)

The following is a summary of Mr. Walther's comments:

- Request for Information. There were two types of information requested from Mr. Harmon, which included: (1) investment documentation; and (2) information or a written analysis of the transactions. Although the slow rate at which the requested data was received was viewed as a problem, the division did take issue with the matter for fear of further slowing the investigation process. A licensee is not required to prove his or her own guilt, the consideration of information supplied by the licensee is not only an important element of due process, but often yields the strongest evidence required for sustainable regulatory action.
- Contacts with Mr. Harmon. The division was requested to respond to the issue of conversations with either Mr. Harmon or his father. Mr. Walther indicated his contact with Mr. Harmon was limited to the previously mentioned hearings and reiterated that the transcripts of those hearings were made public. Additionally, Mr. Walther provided a list of dates he had contact or correspondence with either Mr. Harmon or his attorney. (Please see page 3 of Exhibit E.)

A brief discussion ensued regarding the briefing of the Attorney General on February 28, 1997, regarding the Harmon case and the nature and purpose for the upcoming March 6, 1997, hearing. It was noted by the Chairman that the Attorney General had received a telephone inquiry from the elder Mr. Harmon regarding the subpoena served his son, Harley Harmon junior.

- The representatives from the Attorney General's office are required to provide professional legal advice to their

assigned agency based on the circumstances of each case. From the beginning of the matter, regulatory and statutory options were discussed with L. Scott Walshaw, Commissioner, Division of Financial Institutions, and the decision was made to immediately proceed with the investigation of the mortgage company.

Responding to an inquiry from Assemblywoman Cegavske regarding the procedures of public notification of problems or violations which involve the business practices of financial institutions, Mr. Walther explained that:

- The decision of making a public announcement [for the purpose of warning investors] is not a legal issue, is at the discretion of the division, and does not involve the agency's legal counsel. The general policy of the division is to issue a public statement at the time action is taken.

Ms. Nielsen pointed out that the Attorney General's office will only issue "consumer alerts" or "public service announcements" which address matters where the Attorney General has independent or primary authority for enforcement.

Further, Ms. Nielsen recommended this area of the law be clarified and strengthened to provide the division statutory authority to disclose information pertaining to the investigative findings of financial institutions to persons who make inquiries.

Senator Shaffer advocated the addition of "straightforward" statutory language that would set out the action to be taken by the regulatory agency for specific violations. It was noted that direct and precise language in the statutes would structure the direction of punitive action to be taken by regulators. Additionally, the law should state clearly when to impose fines and suspend or revoke a license, eliminating the potential for discretionary misjudgment.

It was further suggested by Senator O'Donnell to include a statutory provision that would prohibit a financial institution from advertising for new investment money when: (1) monetary difficulties arise; (2) portfolio thresholds fall below a determined amount; or (3) specific problem circumstances are identified within the business practices of a financial institution.

OVERVIEW OF ISSUES AND

PROBLEMS OF THE CREDIT AND LOAN INDUSTRY

Michele Johnson

Ms. Johnson, President, Consumer Credit Counseling Service of Southern Nevada, testified her agency is a nonprofit organization which is certified by the United Way.

She explained the focus of her business involves three components: (1) education; (2) individual debt counseling; and (3) debt repayment, between clients and creditors. It was noted that the agency does not provide debt repair services.

Referring to the recent influx of businesses that specialize in cashing postdated checks, Ms. Johnson described several of the problems which have emerged. Many times the actions of the check-cashing firms have resulted in financial disaster for clients that are already in hardship situations. She explained that:

- The main clientele of the postdated check-cashing businesses are families of low to moderate-earning levels, or senior citizens with limited incomes;
- These check companies often require payments greater than the client's entire monthly income;
- The fees associated with these types of check-cashing businesses make it virtually impossible for a client to pay the total amount owed, causing a "spiral" effect of borrowing; and
- The majority of firms which cash postdated checks do not provide clients with any type of disclosure statements.

A related business which also has increased in number is the small loan company. Ms. Johnson explained these establishments specialize in short-term loan amounts of \$50 to \$750, and charge very high interest rates. Many of

these companies are not bound to the same disclosure regulations as larger financial institutions due to the amounts and terms of the loans. Although, both the postdated check businesses and the small loan companies are regulated by the Division of Financial Institutions, the local district attorneys' deem these transactions as extensions of credit and refuse any involvement.

Ms. Johnson pointed out that because Nevada has no usury law, these small loan companies can charge "exorbitant" rates. She provided additional information which included examples of the excessive interest rates and supplementary fees the check-cashing businesses charge in additions to the total loan amounts.

1. One loan in the amount of \$350 charged an annual rate of 135.62 percent. The firm also assessed a separate document preparation charge of \$25.
2. A small loan office charged a fee of \$175 in addition to the interest on a \$400 loan. The annual rate of this loan was 179 percent.
3. A Las Vegas postdated check business consistently charged an interest rate of 782 percent, another was shown at an annual interest rate of 1,216.66 percent. Additional charges incurred were listed as a \$75 collection fee, \$30 late fee, \$30 service charge, and a certified letter fee in the amount of \$10.

Ms. Johnson recommended the Division of Financial Institutions be authorized to: (1) establish and enforce maximum rate amounts on these types of check-cashing services; (2) prohibit the postdated check services from accepting the amount of the interest payment and "rolling over" the loan amount of the check; and (3) providing strict regulation of both types of financial services.

Senator O'Donnell asked the subcommittee's legal counsel whether or not postdated checks are considered lawful and how they are addressed in the NRS. The Chairman recalled legislation discussed during the 1997 Legislative Session which concened certain aspects of the check-cashing businesses.

Kevin C. Powers, Deputy Legislative Counsel, Legislative Counsel Bureau, indicated he would research the issue and report back to the subcommittee.

REMARKS FROM PERSONS INVOLVED IN THE

MORTGAGE INVESTMENT INDUSTRY IN NEVADA

AND

PUBLIC TESTIMONY

Mark Moreno

Mr. Moreno, Owner, Las Vegas Investment Group Limited, told the subcommittee that revising the disclosure laws will not cure the recent problems experienced in the mortgage investment industry. It is common for investors to not fully understand the disclosure documents and in many instances they do not read the forms thoroughly. Mr. Moreno provided additional information regarding the operation of a mortgage investment firm, and outlined recommendations to the subcommittee. He explained that:

- At the time a mortgage company is created, the Division of Financial Institutions requires certain information to be submitted by the applicant. The application process should be expanded to include:
 1. A basic business plan;
 2. Bonding;

3. Capital requirement;
4. Company policy and procedural manual;
5. Collection policy;
6. Letter of credit;
7. Loan servicing procedures and restrictions; and
8. Underwriting standards.

- The mortgage company owners should never handle investor funds. The entire investment amount should be directly deposited into a money market account when an investment arrangement begins. From that point, an escrow company should handle each step of the transferring of investor funds.

Mr. Moreno contends that problems are likely to be compounded when a mortgage broker is allowed access to investment resources and permitted to make decisions with little oversight. It is a common scenario that the makers of these types of loans that are already in financial "trouble." He explained it is not the practice of his company to solicit public money, but it provides a service of "loan work-outs" by purchasing loans that are financially uncertain and assisting to restructure development companies involved. Mr. Moreno cautioned that when a mortgage company promises a return of 14 to 16 percent interest, investors should be alerted that they may be doing business with inadequate developers.

Concluding, Mr. Moreno recommended that:

- A formula be devised to outline criteria for temporary revocation or suspension of the license of a financial institution;
- A separate NRS section be created to authorize the division to temporarily suspend a license should a certain number of violations occur according to the formula developed; and
- The division be given immediate authority to take control of a financial institution should an order of temporary suspension be issued. The division would further act to administer all transactions, and oversee each phase of the business from that point forward.

Referring to the concept of temporary suspension, he pointed out that the division would have access to files for the purpose of collecting evidence, and no longer be fearful of acting prematurely.

Concluding, Mr. Moreno commended the methods used by both Mr. Walshaw and Mr. Walthers to resolve the issues of the Harmon case in the best interest of the investors and the state.

Following a brief discussion, Chairman Goldwater clarified that the purpose of the subcommittee is not to determine whether criminal acts were committed, but rather to assimilate statutory recommendations and to determine if the regulatory procedures are adequate.

Marty LeVasseur

Mr. LeVasseur, Chairman, Federal Legislation, Nevada Association of Mortgage Brokers, addressed the issue of the disclosure documents that brokers are currently required to provide to investors. He referred to duties and functions promoted by the association in recent years.

During his testimony, Mr. LeVasseur briefly outlined suggestions for the subcommittee's consideration. He recommended that:

- The state adopt regulations requiring continued education by all persons involved in the mortgage investment industry, as well as those seeking certification as a mortgage broker.

- The disclosure documents currently required be reviewed and revised if necessary. It was noted that many of the forms currently used are insufficient for analysis of commercial or major lending ventures.
- The subcommittee endorse stringent enforcement and quality control procedures from regulators and encourage continual education and strict licensing requirements.
- An advisory board be established to address matters related to consumer complaints, education, and licensing, and proceedings against mortgage bankers or brokers.
- The subcommittee encourage additional funds to be allocated to the division to address the shortage of auditors and support staff.

Please refer to Exhibit F for details of Mr. LeVasseur's comments.

Chairman Goldwater indicated there would be further discussion pertaining specifically to the issue of loan servicing at the next meeting and requested representatives from the industry be prepared to provide input.

Ellen Rosario

Ms. Rosario, Las Vegas, relayed to the subcommittee the confusion of many of the investors stemming from the conflicting testimony. She explained that the remarks from persons associated with or employed in the mortgage industry portrayed ideal investment situations, which differed from the business practices of Mr. Harmon.

During her testimony, Ms. Rosario briefly described inquiries she made directly to Mr. Harmon and how his explanations differed from testimony he provided under oath to the Division of Financial Institutions. Further, at the time she invested in the Harley L. Harmon Mortgage Company she perceived Mr. Harmon's explanations of the investment process to be truthful and routine.

Referring to the issue of construction control, Ms. Rosario testified she was under the impression that Nevada law required Mr. Harmon to use an outside company to oversee the inspections required on the construction sites before funds were released.

Ms. Rosario suggested the current statutes be strengthened to provide more protection for investors.

Loretta Eichelberger

Ms. Eichelberger, Las Vegas, experienced a financial loss resulting from an investment placed with the Harley L. Harmon Mortgage Company.

According to Ms. Eichelberger, the State of Nevada and the Attorney General should accept some degree of liability for not taking action against Mr. Harmon immediately following the February 21, 1997, memorandum from Mr. Baker. (Refer to Exhibit C.) Further, Ms. Eichelberger contends that the division should have prohibited Mr. Harmon from misleading advertising and collecting additional funds from new investors during the investigation. She alleged that the division did not follow the guidelines set under NRS.

Responding to a question from Senator Shaffer, Ms. Eichelberger explained that the first loan with Mr. Harmon was paid in full, and she chose to reinvest. It was noted that the practice of second investments being placed with higher risk ventures is known to occur after a mortgage broker gains the trust of the investor.

Ms. Eichelberger recommended that mortgage brokers be required to provide disclosure statements each time funds are reinvested, which was not the practice of Mr. Harmon.

Leo Davenport

Mr. Davenport, past president of the Nevada Mortgage Brokers Association, has been associated with the mortgage investment and real estate businesses since 1974. He expressed concern with the recent problems experienced by investors and frustration with regulatory enforcement methods.

It was noted by Mr. Davenport that Nevada's investment licensing requirements are among the strictest in the country. Referring to issues for consideration by the subcommittee, Mr. Davenport recommended that:

- Loan representatives associated with the mortgage investment industry be licensed and regulated by the Division of Financial Institutions.
- The fees for licensing the state's approximate 3,000 loan representatives could be applied to the division's budget for the purpose of hiring additional auditors.
- An advisory board be created to address issues of the mortgage investment industry, modeled after the board associated with Real Estate Commission, Real Estate Division, Department of Business and Industry.

Mr. and Mrs. Robert Pratt

The testimony of Mr. and Mrs. Robert Pratt echoed the comments describing the distress and frustration experienced by many of the Harmon investors. Mr. Pratt indicated cautious optimism regarding statements from Mr. Walther that the new investment funds may not be at risk. Additionally, if all loan proceeds are "pooled" as recommended by the Attorney General, Mr. Pratt indicated their investment would more than likely be incorporated and therefore, at risk.

Mr. Walther clarified his comment for Mr. Pratt and the subcommittee regarding the new investment funds. He indicated the newer ventures may not have been subject to the abuse from numerous inaccurate transfers and the titles remain "clean."

Responding to Assemblywoman Cegavske regarding the reason charges were not filed against Mr. Harmon with the Clark County District Attorney's Office, Mr. Walter testified it was his understanding that the local authorities were aware of the accusations and investigating the claims when he became involved in the Harmon case.

Jonathan Andrews

Mr. Andrews, Chief Deputy Attorney General, spoke to the general practice followed by the staff of the Office of the Attorney General. When evidence is received regarding a criminal act that is not within the jurisdiction of the AG, the information is referred to the local district attorney. If it is a matter where the AG's office has been advised that local authorities are already involved, no referral would be processed.

Mr. Collins and Assemblywoman Cegavske requested that Mr. Walther provide a written response to clarify the statements pertaining to notifying the district attorney's office.

ADJOURNMENT

Chairman Goldwater thanked those who testified for their participation and announced that all recommendations will be compiled before the next meeting to be used as an outline of a work session document.

There being no further committee business, the Chairman adjourned the meeting at 3:50 p.m.

Respectfully submitted,

Ricka Benum

Senior Research Secretary

APPROVED BY:

Assemblyman David E. Goldwater, Chairman

Date: _____

LIST OF EXHIBITS

Exhibit A is a copy of a document titled "Investing in Trust Deeds," by Jerry A. Trenberth and Jerilyn J. Clayton, submitted by Ms. Clayton.

Exhibit B is document titled "Loan Servicing Agreement," also provided by Ms. Clayton.

Exhibit C is a memorandum to L. Scott Walshaw, from Burns Baker, dated February 21, 1997, titled "Harley L. Harmon Mortgage Company (Inc) Formerly Harley Harmon Mortgage Company, Inc., Examination as of November 30, 1996."

Exhibit D, submitted by Chairman Goldwater, is a letter to Douglas E. Walther, Senior Deputy Attorney General, dated July 29, 1998.

Exhibit E is a letter to David Goldwater, Chairman, Legislative Commission's Subcommittee to Investigate the Regulation of Mortgage Investments, dated August 21, 1998.

Exhibit F consisted of the written remarks of Marty LeVasseur, Chairman, Federal Legislation, Nevada Association of Mortgage Brokers.

Exhibit G is a copy of a letter received from Ms. Jeanette Jarrett in lieu of public testimony, dated August 30, 1998.

Exhibit H is the Attendance Record for this meeting.

Copies of the materials distributed in the meeting are on file in the Research Library of the Legislative Counsel Bureau, Carson City, Nevada. The library may be contacted at (702) 684-6827.