Members:
NOREEN EVANS
DOUG LA MALFA

California State Senate

CONSULTANTS:
BRIAN ANNIS
BRADY VAN ENGELEN

COMMITTEE
ON
BUDGET AND FISCAL REVIEW

SUBCOMMITTEE #4 ON
STATE ADMINISTRATION AND
GENERAL GOVERNMENT

COMMITTEE ASSISTANTS
GLENDA HIGGINS
MARY TEABO

ROOM 5019, STATE CAPITOL
SACRAMENTO, CA 95814

(916) 651-4103
FAX (916) 323-8386

Gloria Negrete McLeod, Chair

UPDATE ON SAFE ACT IMPLEMENTATION

BACKGROUND PAPER

JOINT INFORMATIONAL HEARING OF THE

SENATE BANKING AND FINANCIAL INSTITUTIONS COMMITTEE
Juan Vargas, Chair

and the

SENATE BUDGET AND FISCAL REVIEW SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT
Gloria Negrete McLeod, Chair

Members:
NOREEN EVANS
DOUG LA MALFA

California State Senate

CONSULTANTS:
BRIAN ANNIS
BRADY VAN ENGELEN

COMMITTEE
ON
BUDGET AND FISCAL REVIEW

SUBCOMMITTEE #4 ON
STATE ADMINISTRATION AND
GENERAL GOVERNMENT

COMMITTEE ASSISTANTS
GLENDA HIGGINS
MARY TEABO

ROOM 5019, STATE CAPITOL
SACRAMENTO, CA 95814

(916) 651-4103
FAX (916) 323-8386

Gloria Negrete McLeod, Chair

UPDATE ON SAFE ACT IMPLEMENTATION

JOINT INFORMATIONAL HEARING OF THE

SENATE COMMITTEE ON BANKING & FINANCIAL INSTITUTIONS AND THE SENATE BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT

Senators Juan Vargas and Gloria Negrete McLeod, Chairs

Wednesday, March 7, 2012
State Capitol, Room 112
1:30 PM – 3:00 PM

I. Welcome and Opening Remarks – *Chairs McLeod and Vargas*

II. Update on SAFE Act Implementation

   A. Colleen Monahan, Louisa Broudy, and Michele Bond, Deputy Commissioners, Department of Corporations

   B. Tom Pool and Steve Ellis, Assistant Commissioners, Department of Real Estate

III. Public Comment

IV. Closing Remarks and Next Steps – *Chairs Vargas and McLeod*

UPDATE ON SAFE ACT IMPLEMENTATION IN CALIFORNIA
JOINT INFORMATIONAL HEARING OF THE SENATE BANKING AND FINANCIAL INSTITUTIONS COMMITTEE AND THE SENATE BUDGET AND FISCAL REVIEW SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT

BACKGROUND PAPER

Introduction: The foreclosure crisis currently gripping California had many causes, and has, understandably, generated considerable state and federal action intended to prevent anything similar from happening again. One of the causes of the current crisis, which has generated a great deal of congressional, legislative, and regulatory action, is mortgage loan origination (i.e., the act of taking a mortgage loan application from a borrower and offering or negotiating the terms of a mortgage with that borrower). The logic behind action in this area is based on the premise that every individual who originates a mortgage loan should meet a minimum set of qualifications, should be trained in responsible mortgage loan origination practices, and should be accountable for their actions toward borrowers. Such standards were not in place during the irrationally exuberant 2004 through 2007 time period, and might have helped stem the tide of failed mortgage loans if they had been.

To be clear, mortgage loan origination is only one part of a much larger set of causes addressed by legislators and regulators since the nation's mortgage market imploded. Other key components of the crisis that have resulted in state and federal action include mortgage loan underwriting, real property valuation practices, mortgage loan securitization practices, and mortgage loan servicing practices, among many others. However, mortgage loan origination is one of the few causes that helped contribute to the mortgage crisis, which remains regulated primarily at the state level. It is because mortgage loan origination is regulated primarily by states that a considerable amount of California's recent regulatory focus has centered on the licensing and regulation of mortgage loan originators.

On Wednesday, March 7, 2012, the California Senate Banking and Financial Institutions Committee and the California Senate Budget and Fiscal Review Subcommittee Number 4 on State Administration and General Government will review the status of California's implementation of a comprehensive mortgage loan originator licensing system enacted in 2009. Both committees will ask the two departments that have been responsible for implementing our state's mortgage loan originator licensing laws to review their actions to date. How many licenses have been issued? How many disciplinary actions have been brought? What new information has been collected from licensees? What implementation challenges have been encountered? What staffing issues have arisen?

By jointly reviewing these topics, both the budget subcommittee and the policy committee with jurisdiction over the mortgage loan activities of these departments can work together to ensure that the California public receives the protections intended by the Legislature, when it enacted California's mortgage loan originator licensing scheme.

Background: On July 30, 2008, President George W. Bush signed the Housing and Economic Recovery Act of 2008, whose provisions included the Secure and Fair Enforcement for Mortgage Licensing Act (the SAFE Act). The SAFE Act gave each of the 50 states a choice – either a state could enact a law requiring individual mortgage loan originators doing business in that state to

obtain SAFE Act mortgage loan originator licenses through a nationwide organization called the Nationwide Mortgage Licensing System and Registry (NMLSR); or, the state could fail to act. Any state which failed to act by July 30, 2009, or which acted to comply with the SAFE Act in a manner deemed unacceptable by the United States Department of Housing and Urban Development (HUD), risked intervention by HUD. The SAFE Act authorized HUD to establish and maintain a SAFE Act-compliant mortgage loan originator licensing scheme in any state that voluntarily failed to do so, an act that would, if undertaken by HUD, shift regulatory jurisdiction over the mortgage loan originators licensed in that state from the state to HUD. California opted to enact SAFE Act-compliant legislation, in order to retain its authority to regulate mortgage loan originators operating in California. That implementing legislation was contained in SB 36 (Calderon), Chapter 160, Statutes of 2009.

What Does the Federal SAFE Act Require? The SAFE Act defines the term "mortgage loan originator" as one who takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan for compensation or gain. Administrative and/or clerical employees are not included within the definition. Generally speaking, this term includes both mortgage brokers and loan officers.

The SAFE Act creates a distinction between mortgage loan originators who are employed by depository institutions or subsidiaries of depository institutions, and all other mortgage loan originators. Under the SAFE Act, mortgage loan originators who are *not* employed by a depository institution or a subsidiary of a depository institution must be *both licensed* by their state *and registered* through NMLSR[1]. License applicants must undergo background checks, submit to credit checks, complete pre-licensing education courses approved by NMLSR, pass national and state-specific pre-licensing examinations developed by NMLSR, meet specified personal character requirements specified in the SAFE Act, and pay specified licensing and license processing fees through NMLSR. Once licensed, mortgage loan originators must complete annual continuing education courses approved by NMLSR. Mortgage loan originators must also submit quarterly mortgage loan origination activity reports and annual reports of financial condition to NMLSR (see subsequent section for more detail regarding these reports).

---

[11][1] The NMLSR is a web-based application run by the State Regulatory Registry LLC (SRR), a wholly owned subsidiary of the Conference of State Bank Supervisors. According to the SRR's most recent annual report (http://www.csbs.org/mortgage/Documents/2010%20SRR%20Annual%20Report.pdf), the NMLSR enables state-licensed mortgage lenders, brokers and loan originators to apply for, amend, update or renew licenses online using a single set of uniform applications, and allows federally regulated depository institutions and subsidiaries to register mortgage loan originators, as required by federal banking agencies. For all intents and purposes, the NMLSR is the clearinghouse through which all SAFE Act regulatory filings must be made, and through which all SAFE Act regulatory fees must be paid. States may *not* process SAFE Act applications through their own state-specific systems.

UPDATE ON SAFE ACT IMPLEMENTATION IN CALIFORNIA
JOINT INFORMATIONAL HEARING OF THE SENATE BANKING AND FINANCIAL INSTITUTIONS COMMITTEE AND THE SENATE BUDGET AND FISCAL REVIEW SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT

BACKGROUND PAPER

In California, two departments – the Department of Real Estate (DRE) and the Department of Corporations (DOC) – have jurisdiction over laws that authorize mortgage loan origination activity which requires licensing pursuant to the SAFE Act.

The SAFE Act treats mortgage loan originators who are employed by depository institutions very differently than it treats mortgage loan originators who are employed by non-depositories. In lieu of licensing, the SAFE Act requires mortgage loan originators who are employed by depository institutions or their subsidiaries to *register* on NMLSR, using rules established by the Federal Financial Institutions Examination Council (FFIEC). Registrants must undergo background checks, but are not required to submit to credit checks, nor comply with the education and testing requirements that apply to mortgage loan originators who are required to be licensed under the Act. Because the SAFE Act does not require registrants to register with state licensing entities, California's Department of Financial Institutions (DFI) does not process registration applications submitted by employees of state-licensed depository institutions. Those activities are coordinated entirely by the NMLSR.

How Does California's SAFE Act Law (SB 36) Work?

Real Estate Law Practices and Procedures: Under the provisions of California law, real estate licensees who wish to act as mortgage loan originators must obtain a license endorsement from DRE. Thus, if one wishes to originate mortgages pursuant to the Real Estate Law, one must first obtain a real estate license. Only with that real estate license may an individual apply for a license endorsement to act as a mortgage loan originator. The license endorsement is only available to real estate licensees who comply with the background check and education requirements of the SAFE Act, and who meet the SAFE Act's personal character requirements. Consistent with the SAFE Act, SB 36 requires mortgage loan originators to renew their license endorsements annually.

DRE offers real estate licenses to both individuals and corporations. In order to process SAFE Act mortgage loan originator license applications through the NMLSR, DRE has had to establish three different categories of mortgage loan originators – 1) individual, 2) real estate broker -- sole proprietor company, and 3) real estate corporation company.

Technically, the SAFE Act requires individual (rather than corporate) licensing. Thus, real estate corporation companies do not technically obtain SAFE Act licenses. However, real estate corporations (both sole proprietors and corporation companies) are required to identify themselves as such on the NMLSR. They are also required to ensure that all of their real estate licensee employees who engage in mortgage loan origination activities obtain mortgage loan originator license endorsements. It is illegal for a real estate licensee to originate a residential mortgage without first obtaining a mortgage loan originator license endorsement.

The license fees and NMLSR processing fees that must be paid by each of the different types of real estate licensees are different.

- Individual mortgage loan originators (whether real estate salespersons or real estate brokers) must pay $300 to obtain a mortgage loan originator license endorsement, plus a $30 NMLSR processing fee. Both of these fees are also assessed annually, upon license endorsement renewal. These fees are in addition to the costs for education, testing, credit reporting, and fingerprinting, which are also required of mortgage loan originator applicants and licensees.

- In addition to the fees described above, any real estate broker who is a sole proprietor must pay a $100 NMLS processing fee to register their company on the NMSLR. Thus, an individual real estate broker who originates residential mortgage loans and who is a sole proprietor must pay $430 annually ($300 plus $30 for their individual mortgage loan originator license endorsement, plus $100 to register their sole proprietorship on the NMSLR).

- Real estate corporation companies pay a different amount than sole proprietorships. Each real estate corporation company that originates residential mortgage loans must have a designated officer who holds a mortgage loan originator license endorsement ($300 plus $30) and must pay $300 to register their company on the NMLSR, plus a $100 NMLS processing fee. Thus, a real estate corporation company that originates residential mortgage loans must pay at least $700 annually ($300 plus $30 for the license endorsement for the designated officer, plus $400 to register their corporation on the NMLSR).

Mortgage loan originator license endorsements expire on December 31st of each year, and must be renewed, effective January 1st of the following year.

<u>California Finance Lenders Law (CFLL) and California Residential Mortgage Lending Act (CRMLA) Practices and Procedures:</u> Unlike the Real Estate Law, which licenses both individuals and corporations, the CFLL and CRMLA offered lending licenses only to qualified companies (not individuals) prior to enactment of SB 36. Because the SAFE Act requires that individuals hold mortgage loan originator licenses, SB 36 amended the CFLL and CRMLA to authorize the issuance of mortgage loan originator licenses to individual employees of companies holding CFLL and CRMLA licenses.

Under California law, every employee of a licensed finance lender (CFL) or licensed residential mortgage lender (RML), who engages in mortgage loan origination activities, is required to obtain a mortgage loan originator license. That license is only available to employees who

comply with the background check, education, and testing requirements of the SAFE Act, submit to a credit check, meet the SAFE Act's personal character requirements, and pay the appropriate license and processing fees (though, in practice, many CFLs and RMLs pay the license and processing fees on behalf of their employees). Under California law, a mortgage loan originator license is separate and apart from a CFLL or CRMLA license. Every licensed CFL and RML must ensure that their mortgage loan originator employees hold SAFE Act-compliant mortgage loan originator licenses. It is a violation of law for a CFL or an RML to make a mortgage loan that was originated by an individual who does not hold a mortgage loan originator license.

SAFE Act license fees imposed on mortgage loan originators licensed through DOC are similar to those imposed on mortgage loan originators licensed through DRE. Individual mortgage loan originators must pay $300 to obtain (or renew) a mortgage loan originator license, plus a $30 annual processing fee. These fees are in addition to the costs incurred to pay for required education, testing, credit reporting, and fingerprinting. Each CFL and RML company must pay $100 annually to register through the NMLSR, plus $20 annually to register each branch office location.

Pursuant to the SAFE Act, mortgage loan originator licenses expire on December 31st of each year, and must be renewed, effective January 1st of the following year.

Banking Law and Credit Union Law: SB 36 did not amend California's Banking or Credit Union Laws. Instead, California's DFI has directed its bank and credit union licensees to follow the SAFE Act regulations issued by the FFIEC. DFI examines its licensees for compliance with those regulations during its periodic regulatory examinations.

SAFE Act Reporting Requirements: The SAFE Act requires licensed mortgage loan originators to submit two different types of periodic reports through the NMLSR – a quarterly "call" report, which provides a snapshot of the volume and nature of residential mortgage loan origination activity conducted during each calendar quarter by each firm that employs licensed mortgage loan originators, and an annual "report of financial condition," which provides information about the financial condition of those firms. These reports are required to be filed at the company level, unless a mortgage loan originator licensee is a sole proprietor.

So, for example, if XYZ Mortgage Company is licensed to do business in California under either the Real Estate Law, CFLL, or CRMLA, that company would aggregate the mortgage loan origination activity of its California-licensed mortgage loan originators on a quarterly basis, and report those data through NMLSR in its quarterly call reports. Individual call reports would not need to be submitted by each of the individual mortgage loan originators employed by XYZ. On an annual basis, within 90 days following the end of its fiscal year, XYZ Company would have to submit a separate Report of Financial Condition through the NMLSR, containing information about its company finances.

It is important to note that neither of these SAFE Act-required reports can be customized by individual states. For that reason, if California wishes to obtain information from its mortgage loan originator licensees, which is different from, or in addition to the information which is required of these individuals pursuant to the SAFE Act, California must require the submission of separate reports containing this information. SB 36 contained an individual reporting requirement of this type, to provide DRE with certain information about its mortgage loan originators, which the Department had previously lacked, and which was not required by the SAFE Act. These additional reports, called "business activity reports" by DRE, are intended to provide DRE with information it can use to focus its limited examination resources on licensees most in need of regulatory review. The information requested in these reports is focused on those activities, which pose the greatest potential risk of harm to the public.

SB 36 did not require CFLs or RMLs to submit additional, separate reports, because the CFLL and the CRMLA already require submission of annual reports by these licensees.

Funding Background

Funding for the SAFE Act: Recognizing that the SAFE Act introduced new workload requirements for DRE, the Legislature approved $2.8 million and 27 positions in the 2010-11 budget for the implementation of SB 36. The Legislature also approved 8 positions and $1.285 million to address new workload requirements stemming from the SAFE Act at DOC.

There were no additional increases to either department's budget approved in the 2011-12 budget. However, DRE did submit a request that was considered and denied without prejudice during a budget subcommittee hearing, it is important to note that the state's fiscal situation played a role in determining the need of each department.

Proposed 2012-13 Budget: DOC is funded from special funds and reimbursements, with the largest amount of support provided by the State Corporations Fund. The 2012-13 budget proposes expenditures of $45.3 million and would support 314.7 positions. The lender-fiduciary division of DOC is responsible for the licensing and regular examination of mortgage bankers and lenders which are activities that require oversight pursuant to the SAFE Act. The proposed 2012-13 budget includes 154.3 positions for the lender-fiduciary division of DOC.

Much like DOC, DRE is funded through special funds. The 2012-13 budget proposes expenditures of $47.1 million to support 348.7 positions in the department. Support for the implementation of the SAFE Act is integrated into several divisions within DRE, including licensing and education, enforcement, audits and recovery and administration.

Vacant Positions: As of January 23, 2012 there were 33 vacancies at DOC. The Department was subject to the statewide hiring freeze from August 31, 2010 thru September 28, 2011. The tables below represent historical data reflecting the authorized positions within DOC and DRE and vacant positions within each program.

There are no new proposals for either department included in the 2012-13 budget proposal.

The Department of Corporations

Authorized Positions	2007-08	2008-09	2009-10	2010-11	2011-12
Program 10: Investment	160.5	166.8	167.8	167.9	161.0
Program 20: Lender-Fiduciary	151.9	153.2	154.2	164.1	159.0
Program 50.01: Administration	58.0	58.0	60.0	66.0	66.0
Program 50.02: Distributed Admin.	-58.0	-58.0	-60.0	-66.0	-66.0
Total Authorized Positions	312.4	320.0	322.0	332.0	320.0
Vacant Positions					
Program 10: Investment	16.0	12.0	15.0	19.0	21.0
Program 20: Lender-Fiduciary	32.0	11.0	10.0	23.0	22.0
Program 50.01: Administration	6.0	5.0	7.0	14.0	12.0
Program 50.02: Distributed Admin.	-6.0	-5.0	-7.0	-14.0	-12.0
Total Vacant Positions	48.0	23.0	25.0	42.0	43.0

The Department of Real Estate

*includes 12 vacancies that are subject to workforce cap plan reduction proposed in 2012-13 budget

Authorized Positions	2007-08	2008-09	2009-10	2010-11	2011-12
Program 10: Licensing and Education	59.5	58.5	57.5	72.5	72.5
Program 20: Enforcement, Audits and Recovery	176.5	177.5	179.5	202.5	202.5
Program 30: Subdivisions	57	56	51	38	38
Program 40.10: Administration	49	52	53	55	55
TOTAL AUTHORIZED POSITIONS	342	344	341	368	368
Vacant Positions					
Program 10: Licensing and Education	2	6.5	5	2	1
Program 20: Enforcement, Audits and Recovery	5	15	12	3	12.5
Program 30: Subdivisions	2	8	5	0	1
Program 40.10: Administration	8	7	1	6	2
TOTAL VACANT POSITIONS	17	36.5	23	11	16.5*