

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians*

INITIAL STATEMENT OF REASONS FOR PROPOSED REGULATORY ACTION
UNDER
THE CALIFORNIA FINANCE LENDERS LAW AND
THE CALIFORNIA RESIDENTIAL MORTGAGE LENDING ACT
PRO 06/14

Statement of Specific Purpose (Government Code Section 11346.2, Subdivision (b)(1))

The Department of Business Oversight (Department) licenses and regulates lenders, brokers, and mortgage loan originators under the California Finance Lenders Law (Fin. Code, § 22000 et seq.) and residential mortgage lenders, servicers, and mortgage loan originators under the California Residential Mortgage Lending Act, (Fin. Code, § 50000 et seq.). Under the California Finance Lenders Law and the California Residential Mortgage Lending Act, the Commissioner must deny an application for a mortgage loan originator license unless the Commissioner makes specified findings, among other things, that the applicant has: (1) completed at least 20 hours of prelicensing education; and (2) passed a qualified written test. In order to renew his or her license, a mortgage loan originator must comply with specified requirements, including completing at least eight hours of continuing education.

A. Mortgage Loan Originator Education and Testing Requirements Prior to Senate Bill 1459

Senate Bill 1459 (Chap. 123, Stats. 2014), which became effective on January 1, 2015, amended the mortgage loan originator education and testing requirements. Prior to Senate Bill 1459, in order to meet the prelicensing education requirement, a person had to complete at least 20 hours of education that included: (1) three hours of federal law and regulations; (2) three hours of ethics, which included instruction on fraud, consumer protection, and fair lending issues; and (3) two hours of training related to lending standards for the nontraditional mortgage product marketplace. California did not prescribe the content of the remaining 12 hours of prelicensing education.

In order to meet the annual continuing education requirements, a state-licensed mortgage loan originator had to complete at least eight hours of education that included: (1) three hours of federal law and regulations; (2) two hours of ethics, which included instruction on fraud, consumer protection, and fair lending issues; and (3) two hours of training related to lending standards for the nontraditional mortgage product marketplace. California did not prescribe the content of the remaining two hours of continuing education.

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In addition to the prelicensing education requirements, mortgage loan originators had to pass a qualified written test developed by the Nationwide Mortgage Licensing System and Registry (NMLS) to qualify for a mortgage loan originator license. A qualified written test must adequately measure the applicant's knowledge and comprehension in specified subject areas. The qualified written test includes two parts; a national component and a California component, based on the original test design of the NMLS.

However, in response to industry concerns regarding the regulatory burden associated with requiring separate individual state components, the NMLS developed and adopted, on April 1, 2013, a Uniform State Test, which replaces the state-specific test components for states that adopt it. While 40 other states have adopted the new Uniform State Test, California has not because its current regulations require applicants to pass a qualified written test that consists of a national component and a California component. The Uniform State Test only tests applicants on their knowledge of high level state-related content that is based on the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) and the Model State Law¹, which many states, including California, used to implement the SAFE Act. The Uniform State Test would not test applicants on California specific laws.

B. Changes to Mortgage Loan Originator Education and Testing Requirements Pursuant to Senate Bill 1459

Senate Bill 1459 modified the testing and education licensure and renewal requirements for mortgage loan originators. Specifically, Senate Bill 1459: (1) requires mortgage loan originator applicants to take two hours of training related to relevant California law and regulations for licensure; (2) requires mortgage loan originator licensees to complete one hour of training related to relevant California law and regulations for renewals; and (3) enables the Department to adopt qualified written tests that are "deemed acceptable" by the NMLS, in addition to tests that are "developed" by the NMLS.

The purpose of this rulemaking is to confirm and clarify the California Finance Lenders Law and California Residential Mortgage Lending Act education and testing requirements for licensure and renewals, as updated by Senate Bill 1459. This rulemaking action would update the Department's mortgage loan originator regulations to include Senate Bill 1459's education and testing requirements. The action also adopts the Uniform State Test as the qualified written test that qualifies individuals to get a mortgage loan originator license.

¹ The Model State Law was developed by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) and approved by the U.S. Department of Housing and Urban Development and the Consumer Financial Protection Bureau, based on their findings that it met the minimal standards of the SAFE Act, for use by states in drafting their respective SAFE Act laws.

This proposed rulemaking action would amend sections 1422.6.1, 1422.6.3, 1950.122.5.1 and 1950.122.5.3, of title 10 of the California Code of Regulations, to implement the new mortgage loan originator testing and education requirements in the California Finance Lenders Law and the California Residential Mortgage Lending Act.

Section 1422.6.1. Qualifications of Mortgage Loan Originator Applicants.

Senate Bill 1459 provided that for the purposes of mortgage loan originator licensure requirements, in the California Finance Lenders Law, a qualified written test includes one that is “deemed acceptable” by the NMLS. Prior to Senate Bill 1459, a qualified written test was defined as one that was “developed” by the NMLS. Senate Bill 1459 expanded the selection of tests from which the Department may choose to accept for the licensure of mortgage loan originators. The proposed amendments to section 1422.6.1 would incorporate these changes in the Department’s mortgage loan originator regulations.

The proposed amendments to section 1422.6.1 would clarify that the definition of qualified written test includes a test with a national component with “uniform state content.” Currently, the Department can require a mortgage loan originator to pass any qualified written test that is “developed” or “deemed acceptable” by the NMLS and contains a national component and a “California specific component” in order to obtain licensure. The proposed amendments to section 1422.6.1 would clarify that the definition of a qualified written test includes a test that contains a “state specific component.” Specifically, the proposed regulations would authorize the Department to adopt the Uniform State Test, by removing the current limitation that a qualified written test must include a “California component.”

Senate Bill 1459 provided that for the purposes of mortgage loan originator licensure requirements, in the California Finance Lenders Law, applicants must complete a California prelicensing education requirement in order to obtain a license. Currently, a mortgage loan originator applicant must complete 20 hours of NMLS approved courses for licensure. Prior to Senate Bill 1459, the 20 hours had to include: three hours of instruction on federal law and regulations; three hours of ethics; and two hours of training related to lending standards for the nontraditional mortgage product marketplace. Senate Bill 1459 modified the prelicensing requirements to require that a mortgage loan originator applicant also take two hours of training related to relevant California law and regulations. The proposed amendments to section 1422.6.1 would incorporate these changes in the Department’s mortgage loan originator regulations. Additionally, the amendments would clarify that the two hours of training related to relevant California law and regulations would be included in the total 20 required hours of prelicensing education.

The proposed changes to the section are necessary to make the requirements for mortgage loan originator licensure in the Department’s regulations consistent with the qualified written test and California specific prelicensing education statutory

mortgage loan originator requirements that became effective January 1, 2015, pursuant to Senate Bill 1459. Also, the proposed change to the qualified test criteria would enable the Department to require applicants to take and pass the Uniform State Test for licensure.

Section 1422.6.3. Continuing Education and Renewal Requirements for Mortgage Loan Originators.

Senate Bill 1459 provided that for the purposes of mortgage loan originator licensure renewal requirements, under the California Finance Lenders Law, licensees must complete California continuing education requirements in order to renew a license. Currently, a mortgage loan originator licensee must complete eight hours of NMLS approved courses for licensure renewal. Prior to Senate Bill 1459, the eight hours had to include: three hours of instruction on federal law and regulations; two hours of ethics; and two hours of training related to lending standards for the nontraditional mortgage product marketplace. Senate Bill 1459 modified the continuing education requirements to require that a mortgage loan originator licensee also take one hour of training related to relevant California law and regulations. The proposed amendment to section 1422.6.3 would incorporate these changes in the Department's mortgage loan originator regulations. Additionally, the amendment would clarify that the additional hour of training related to relevant California law and regulations would be included in the total eight required hours of continuing education.

The amendment is necessary to ensure that the California Finance Lenders Law regulations for mortgage loan originators are consistent with the California specific continuing education statutory mortgage loan originator requirement that became effective January 1, 2015, pursuant to Senate Bill 1459.

Section 1950.122.5.1. Qualifications of Mortgage Loan Originator Applicants.

Senate Bill 1459 provided that for the purposes of mortgage loan originator licensure requirements, in the California Residential Mortgage Lending Act, a qualified written test includes one that is "deemed acceptable" by the NMLS. Prior to Senate Bill 1459, a qualified written test was defined as one that was "developed" by the NMLS. Senate Bill 1459 expanded the selection of tests from which the Department may choose to accept for the licensure of mortgage loan originators. The proposed amendments to section 1950.122.5.1 would incorporate these changes in the Department's mortgage loan originator regulations.

The proposed amendments to section 1950.122.5.1 would clarify that the definition of qualified written test includes a test with a national component with "uniform state content." Currently, the Department can require a mortgage loan originator to pass any qualified written test that is "developed" or "deemed acceptable" by the NMLS and contains a national component and a "California specific component" in order to obtain licensure. The proposed amendments to section 1950.122.5.1 would clarify that

the definition of a qualified written test includes a test that contains a “state specific component.” Specifically, the proposed regulations would authorize the Department to adopt the Uniform State Test, by removing the current limitation that a qualified written test must include a “California component.”

Senate Bill 1459 provided that for the purposes of mortgage loan originator licensure requirements, in the California Residential Mortgage Lending Act, applicants must complete a California prelicensing education requirement in order to obtain a license. Currently, a mortgage loan originator applicant must complete 20 hours of NMLS approved courses for licensure. Prior to Senate Bill 1459, the 20 hours had to include: three hours of instruction on federal law and regulations; three hours of ethics; and two hours of training related to lending standards for the nontraditional mortgage product marketplace. Senate Bill 1459 modified the prelicensing requirements to require that a mortgage loan originator applicant also take two hours of training related to relevant California law and regulations. The proposed amendments to section 1950.122.5.1 would incorporate these changes in the Department’s mortgage loan originator regulations. Additionally, the amendments would clarify that the two hours of training related to relevant California law and regulations would be included in the total 20 required hours of prelicensing education.

The proposed changes to the section are necessary to make the requirements for mortgage loan originator licensure in the Department’s regulations consistent with the qualified written test and California specific prelicensing education statutory mortgage loan originator requirements that became effective January 1, 2015, pursuant to Senate Bill 1459. Also, the proposed change to the qualified test criteria would enable the Department to require applicants to take and pass the Uniform State Test for licensure.

Section 1950.122.5.3. Continuing Education and Renewal Procedures for Mortgage Loan Originators.

Senate Bill 1459 provided that for the purposes of mortgage loan originator licensure renewal requirements, in the California Residential Mortgage Lending Act, licensees must complete a California continuing education requirement in order to renew a license. Currently, a mortgage loan originator licensee must complete eight hours of NMLS approved courses for licensure renewal. Prior to Senate Bill 1459, the eight hours had to include: three hours of instruction on federal law and regulations; two hours of ethics; and two hours of training related to lending standards for the nontraditional mortgage product marketplace. Senate Bill 1459 modified the continuing education requirements to require that a mortgage loan originator licensee also take one hour of training related to relevant California law and regulations. The proposed amendment to section 1950.122.5.3 would incorporate these changes in the Department’s mortgage loan originator regulations. Additionally, the amendment would clarify that the additional hour of training related to relevant California law and regulations would be included in the total eight required hours of continuing education.

The amendment is necessary to ensure that the California Residential Mortgage Lending Act regulations for mortgage loan originators are consistent with the California specific continuing education statutory mortgage loan originator requirement that became effective January 1, 2015, pursuant to Senate Bill 1459.

Major Regulations (Government Code Section 11346.2, Subdivision (b)(2))

The Department has determined that this rulemaking action is not a major regulation.

Studies Relied Upon (Government Code Section 11346.2, Subdivision (b)(3))

The Department relied upon the following technical reports in proposing this rulemaking action: (1) State-Specific Education Requirements PE and CE, January 6, 2015, State-Specific NMLS Required Education Charts 2015²; and (2) NMLS UST Adoption Table and Map, State Regulatory Registry LLC, last updated 10/02/2014³.

Potential for Adverse Economic Impact on Business and Individuals (Government Code Section 11346.3, Subdivision (a))

The Commissioner has determined that the proposed regulatory action will not have an adverse economic impact or potential for an adverse economic impact on business, including the ability of California businesses to compete with businesses in other states, or individuals. The proposed rulemaking action would only incorporate Senate Bill 1459's new mortgage loan originator education and testing provisions in the Department's mortgage loan originator regulations. The proposed rulemaking action may result in minor cost savings and a reduction in test preparation time for some mortgage loan originators due to the replacement of the California-specific test with the Uniform State Test.

There are currently 40 states (including the District of Columbia) that have adopted the Uniform State Test in place of state-specific testing, including: Alabama, Alaska, Connecticut, Delaware, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Montana, Nebraska, Nevada, New Hampshire, Maine, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah (Department of Financial Institutions only), Vermont, Virginia, Washington, Wisconsin and Wyoming.

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<http://mortgage.nationwidelicensingsystem.org/courseprovider/Course%20Provider%20Resources/State%20Specific%20Education%20Requirements.pdf>

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<http://mortgage.nationwidelicensingsystem.org/profreq/testing/Documents/UST%20Adoption%20Table%20and%20Map.pdf>

Of those 40 states, 19 require state-specific prelicensing education of two to five hours. Of those states, 15 require one to four hours of state-specific continuing education. Nevada requires state-specific prelicensing education of four hours and continuing education of three hours, New Mexico requires three hours of state-specific prelicensing education and one hour of state-specific continuing education, and New York requires three hours each of state-specific prelicensing and continuing education.

While ten states have not adopted nor indicated their intentions to adopt the Uniform State Test, seven of those states require state-specific prelicensing education between one to four hours. Of the five states that have indicated they will not adopt the Uniform State Test, one requires state-specific prelicensing and continuing education.

Therefore, the Department has determined that: (1) requiring applicants to take the Uniform State Test; and (2) incorporating Senate Bill 1459's California specific prelicensing and continuing education requirements in the Department's mortgage loan originator regulations, will not impact mortgage loan originators' ability to compete with businesses in other states. Mortgage loan originators continue to participate in the marketplace in other states that have implemented similar licensure requirements.

Economic Impact Assessment (Government Code Section 11346.3, Subdivision (b))

The Creation or Elimination of Jobs within the State

The Commissioner has determined that this regulatory proposal will not have a significant impact on the elimination of jobs in the State of California, but may help create jobs in the state. This proposed rulemaking action's provisions to adopt the Uniform State Test may encourage additional mortgage loan originators to obtain licensure in California, as passage of the test in one state satisfies the testing requirement for all states, in which it is adopted. Other states have experienced a 29% increase in their mortgage loan originator applicants when they adopted the Uniform State Test.⁴ Since California's licensure requirements, among other things, require mortgage loan originators to be employed by a finance lender or broker or residential mortgage lender or servicer that is currently licensed by the Department, it is likely existing businesses will create more jobs to accommodate them.

The Creation of New Businesses or the Elimination of Existing Businesses within the State

The Commissioner has determined that this regulatory proposal will not have a significant impact on the creation of new businesses or the elimination of existing businesses in the State of California. This is because although the proposal may encourage additional mortgage loan originators to become licensed in California, they will likely seek employment with existing businesses since their licensure requirements,

⁴ Number of MLO Applications by Quarter – TX, WA, CA, Natl. report produced by the Conference of State Bank Supervisors, December 5, 2014.

among other things, include being employed by a finance lender or broker or residential mortgage lender or servicer that is currently licensed by the Department.

The Expansion of Businesses Currently Doing Business within the State

The Commissioner has determined that this regulatory proposal will not have a negative impact on the expansion of businesses currently doing business in California. Instead the proposal may result in the expansion of businesses currently doing business in California because it may encourage additional mortgage loan originators to become licensed in California. In order to become licensed in the state, a mortgage loan originator must be employed by a finance lender or broker or residential mortgage lender or servicer that is currently licensed by the Department.

The Benefits of the Regulations to the Health and Welfare of California Residents, Worker Safety and the State's Environment

The Commissioner has determined that this regulatory proposal may benefit the health and welfare of California residents by ensuring that mortgage loan originator licensees and applicants are knowledgeable about California lending laws so that they may properly originate appropriate loans for borrowers. The provisions to adopt the Uniform State Test will help the state's economy by encouraging mortgage loan originators to obtain licensure in California, as passage of the test in one state satisfies the testing requirement for all states, in which it is adopted.

Reasonable Alternatives (Government Code Section 11346.2, Subdivision (b)(4))

- (A) The Department is not aware of any reasonable alternative that would achieve the same purpose but be less burdensome and equally effective. The Department is not aware of any less burdensome and equally effective alternative that would allow a mortgage loan originator applicant to meet the test requirement for the mortgage loan originator license. The action's provisions to adopt the Uniform State Test would help mortgage loan originators more easily satisfy the "qualified written test" requirement for licensure in California, as passage of the test in one state satisfies the testing requirement for all states, in which it is adopted. The Department has considered maintaining its current state specific test requirement for mortgage loan originator applicants and determined that maintaining the current state test would be more burdensome for the Department and applicants. Also, the Department is not aware of any less burdensome and equally effective alternative that would ensure that mortgage loan originator applicants and licensees do not become confused by the inconsistency in education requirements in California law and regulations. The Department determined that incorporating Senate Bill 1459's education requirements in its mortgage loan originator regulations would be the best alternative.

- (B) The Department has considered whether reasonable alternatives are available to lessen any adverse impact on small business. Since the proposed rulemaking action would not have any adverse impact on small businesses, the Department has not proposed any alternatives to the action.

Evidence Relied Upon (Government Code Section 11346.2, Subdivision (b)(5))

In making the determination that this rulemaking action will not have a significant adverse impact on business, the Department has relied on evidence of other states' requirements for mortgage loan originators to take prelicensing and continuing education courses,⁵ which are specific to their respective states' laws, and to pass the Uniform State Test.⁶

⁵ State-Specific Education Requirements PE and CE, January 6, 2015, State-Specific NMLS Required Education Charts 2015.

⁶ NMLS UST Adoption Table and Map, State Regulatory Registry LLC, last updated 10/02/2014.