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New state rules get tough on mortgage brokers

New rules aim to weed out those who overindulged in subprime lending

Richard H. Neiman of the New York State Banking Department

By Abby Luby

If you're about to become a mortgage loan originator for residential real estate in New York State – whether you work for a company as a loan officer, or match customers to loans as a mortgage broker – there are some new rules to follow. Starting Jan. 1, 2008, new mortgage loan officers must now apply to be authorized by the New York State Banking Department. If you're already a practicing mortgage loan officer, you must file for authorization by July 1, 2008.

The new regulations seek to weed out brokers who overindulged in subprime lending, which resulted in soaring foreclosure rates and had a worldwide ripple effect. In a Dec. 20th announcement, the superintendent of the New York State Banking Department, Richard H. Neiman, said the new rules were about reducing mortgage fraud and finding brokers who were evading enforcement. "We are creating a heightened level of protection for consumers and generating a greater sense of stability in an industry that has been significantly impacted by the recent subprime crisis," Neiman said.

The application will ask for a full description of educational and professional experience, credit history, fingerprints and financial and criminal disclosures.

“On our end, we will be going through the actual application and doing a background check,” explained Jackie McCormack, director of communications for the banking department.

Brokers can still work while their application is being processed, McCormack said. “For beginning MLOs [mortgage loan originators], the sponsoring entity must receive notification from the banking department that a complete application has been received. [But] we don’t want to hold people up getting their approval.”

Still, some feel the new system puts an unwarranted cloud over mortgage brokers. “Mortgage brokers, even the best of the bunch, are getting a bad rep,” said Cynthia Saxman, a senior loan officer at Preferred Empire Mortgage Company in Manhattan.

Saxman, who has been in the business for 17 years and owned her own company for 13, ultimately blames the banks and investors for the brokers’ new plight. “The banks and investors created the vehicles – and mortgage brokers took the deals, and the banks were rewarded,” she said.

Saxman is hoping the new regulations can find the few “bad apples” – brokers who became too lax with lending standards and made subprime loans to homebuyers who were unable to pay them back.

The state banking department estimated about 40,000 applications will be received through its new online system in the next two years.

“By Jan. 2, 2008, there will be an online system for MLOs to submit their applications and get a confirmation number,” said McCormack. “Until April 1, we are accepting applications from new entities. They cannot begin to originate loans until we receive their application.”

McCormack said new mortgage loan officers will be processed first. All brokers must be authorized by January 2010; they can continue to work up until that date unless their application has been denied.

An application can be denied if a loan originator has a prior conviction for a felony connected to loan originating, or if their license has been revoked in another state that regulates mortgage loan originators.

A new national fraud registry called the NMLS will be launched this month. The registry will cover licensing and enforcement actions in the mortgage brokerage business and is designed to catch brokers working over state lines. Forty-two state agencies from across the country will funnel mortgage loan officer applications to this system, said Bill Matthews, president of the State Regulatory Registry LLC, a non-profit organization that will operate the database.

“The database will house all of the licensee’s information from the states and will reveal any publicly adjudicated enforcement actions,” said Matthews. “This system will have a profound impact on the way the industry is regulated.”

Matthews said by 2009 the public will be able to look up a broker or lender on the online database.

Most states will take the applications; the ones that have not are California, Maine, Minnesota, Missouri, Nevada, Ohio, South Carolina, Texas, Virginia and Wisconsin.

“These other states haven’t said no; it’s just a state-by-state decision. We anticipate all 50 will be on there," he said.

Oversight for the lending community is creating many new levels of bureaucracy; the state banking department has already added staff to process the applications. Investors are hoping that the result will be a more assured lending community.

"You can't just give people money without knowing if they have the ability to pay you back," said Todd E. Soloway, the chair of Pryor Cashman's Real Estate Litigation Group. "The new regulations will ultimately restore confidence in the investment communities who are buying the mortgages. They'll know lenders are being responsible by underwriting loans, and lenders are better served because they are more likely to get repaid."

In late December, the Federal Reserve also proposed new rules affecting the entire mortgage market, including banks and non-bank lenders, mortgage brokers and mortgage-servicing companies.

The proposed rules, now going through a 90-day public comment period, would prohibit lenders from making high-cost loans to people without verifying their income or assets. Also, lenders would be required to set up escrow accounts ensuring subprime borrowers' property taxes and home insurance were paid, a safety measure many subprime lenders avoided.

Back on the state level, to keep their licenses, brokers will be required to take 18 hours of education courses every two years, including classes in ethics.

"The courses have to be approved by the banking department," said McCormack. "Teachers will be from different local colleges and industry organizations."

Many brokers say the rules shouldn't apply to everyone. "There are many more good brokers out there than there are bad," Saxman said. "The New York City foreclosure market is not like it is in Middle America or other parts of New York State. But the rules should weed out all the good from the bad, and if you have nothing to hide, it shouldn't be a big deal."