



STATE OF MARYLAND  
DEPARTMENT OF LABOR, LICENSING AND  
REGULATION  
COMMISSIONER OF FINANCIAL REGULATION

## **IMPLEMENTATION OF RISK-BASED APPROACH TO MORTGAGE LENDER EXAMINATION**

REPORT TO THE  
SENATE FINANCE COMMITTEE  
AND  
HOUSE ECONOMICS MATTERS COMMITTEE

October 1, 2012

Mark Kaufman, Commissioner of Financial Regulation

# EXECUTIVE REPORT

## IMPLEMENTATION OF RISK-BASED MORTGAGE LENDER LICENSEE EXAMINATION SCHEDULE

### **Background**

Chapter 332 of the Laws of Maryland (2011) introduced as House Bill 358, and cross-filed with Senate Bill 103, entitled – Office of the Commissioner of Financial Regulation, the Banking Board, and the State Collection Agency Licensing Board – Sunset Extension and Program Evaluation requires the Commissioner of Financial Regulation to report on or before October 1, 2012 on the implementation of a risk-based scheduling approach to mortgage lender examinations. A risk-based examination scheduling structure is an examination protocol based on a series of risk factors that may result in a higher frequency of examination for licensees that poses a greater operational risk level, and a lesser frequency of examination for licensees possessing a lower operational risk level.

The current criteria for examining mortgage lenders, brokers and servicers can be found in the Financial Institutions Article, §11-515 – Investigatory powers and duties of the Commissioner, complaints, Examination of licenses, Md. Code Annotated. This section requires the examination of each licensee in accordance with a schedule established by the Commissioner and at any other time the Commissioner reasonably considers necessary. The schedule established by the Commissioner must take into account:

- The length of time the licensee has been engaged in business as a mortgage lender;
- Any prior violations by the licensee of the mortgage lending law or regulations;
- The nature and number of any complaints made against the licensee;
- The results of findings from any prior examination of the licensee; and

- Any schedule of examination established by the Commissioner must provide for the examination of:
  - New licensees within 18 months of the date the license is issued; and
  - Each licensee at least once during any 36 month period.

The current law provides a limited risk assessment when determining the examination schedule such as the nature and number of any complaints made against the licensee, however, the implementation of other risk assessments into examination scheduling not only enhances the development of a risk-based examination system, but also provides the Commissioner with additional information in detecting problem licensees, thereby minimizing potential harm to Maryland consumers.

A major source for obtaining risk assessment information is the Nationwide Mortgage Licensing System (“NMLS”). The NMLS centralizes the licensing and data collection of all mortgage lending businesses and loan originators by providing one common and unique identifier license number and record for each mortgage lender and loan originator. Effective July 1, 2012 and pursuant to §11-513.1 of the Maryland Mortgage Lender Act (MLL), licensees are required to submit to the NMLS a call report once each quarter on the date, in the form, and containing the information required by the NMLS. The call reports will provide the Commissioner with additional information on the practices and conduct of licensees, and enhances the information sharing of mortgage lending regulators throughout the country. The Commissioner will pull this information on a quarterly basis from the NMLS, and factor the call report information into the risk-based scheduling system. As of the writing of this Executive Report, the Commissioner has successfully transitioned all mortgage lender licensees into the NMLS.

### **Implementation of Risk Based Examinations**

As of January 1, 2012, the Commissioner implemented a risk-based examinations process to supplement the required periodic examination requirements pursuant to the MLL § 11-515. The

intent of risk-based examinations is to provide more intense oversight of those licensees who have demonstrated, through examination or complaint, deficiencies in compliance with state and federal statutes and regulations governing residential mortgage lending in the State of Maryland.

The Commissioner developed the following rating system to assign risk factors to licensees:

<b>Rating</b>	<b>Brief Description</b>	<b>Factors</b>
1	No exceptions in a completed examination	No violations
2	Minor documentary issues of non-compliance	Technical disclosure violations, or documentation issues, no monetary harm to the consumer
3	Repeated or pervasive, documentary issues of non-compliance	Technical disclosure violations, or documentation issues, resulting in refunds to consumers and/or small civil penalties.
4	Financial impact on consumer -significant refunds	Major disclosure violations, or documentation issues, resulting in significant refunds to consumer and/or civil penalties.
5	Major issues of non-compliance	Failure to respond to examination queries, unlicensed activity, deceptive practices, potential risk of significant consumer harm.

Note: The risk rating will dictate the expediency by which the next examination is conducted. Higher risk dictates more frequent examination while lesser risk will be factored into the regularly necessitated calendar based examination of a given entity.

The above Risk Rating System is currently used by the Commissioner in determining the licensee's risk level and frequency of examination. In determining the level of risk posed by a licensee, a series of risk assessment factors are analyzed by the Commissioner and then applied to the universe of licensees that must be examined. Licensees are categorized into risk level buckets ranging from Level 1, the best possible risk rating requiring minimal examinations, to Level 5, the worst possible rating requiring frequent examinations. Since adopting the Risk Rating System approach in January 2012, the Commissioner has been transitioning licensees into risk level buckets based on the most recent examination performed. Additional risk

assessment data collected from the NMLS such as call reports and enforcement actions are analyzed and factored into the risk level buckets by staff. The Supervisor/Director of Mortgage Compliance assigns the final rating in the Report of Examination based on the following criteria:

- Licensee's response to current examination findings;
- The nature and seriousness of exceptions cited in the examination;
- History of previous exceptions;
- Deleterious effect of examination exceptions on the public and mortgage industry; and
- Any other factors relevant to the level of risk originated by the licensee.

### **Summary**

It is our belief that the above risk-based examination scheduling structure for the examination of Maryland mortgage lenders will supplement the current examination structure, and provide the Commissioner with greater flexibility in identifying and examining lenders that may pose a greater harm to Maryland consumers, as well as enhance the examination compliance of Maryland mortgage lender licensees. As the mortgage industry continues to evolve, so does the Commissioner's ability to engage in meaningful data collection relative to the conduct and practices of mortgage lender licensees.