Unit 10
Settlement & Closing

Introduction
The closing of a real estate transaction is the final milestone on the path that began with making the sale. The closing process includes signing documents that transfer the title of the property from the seller to the buyer and the distribution of funds. Closing and settlement are interchangeable terms.

Once a lender approves the loan, it goes to the final stage of the real estate loan approval process—the loan closing—at which time necessary documents are prepared and executed. At the closing or settlement table, the borrower receives the package of closing documents, some of which must be signed before a notary. The borrower signs the note and security instruments (deed of trust or mortgage) and various accompanying disclosures. Once the borrower has executed all documents, the loan is funded and the deed of trust or mortgage (as applicable) is recorded.

In this unit, you will learn about title insurance, property taxes, and basic closing and funding procedures.

Learning Objectives
After completing this Unit, you should be able to:

- recall the process of closing (settlement).
- designate the role of the participants in the closing.
- identify marketability of title.
- identify property tax issues.
- categorize the various closing costs.
- recognize elements of the loan closing process.
Settlement

Settlement, or closing, is the final meeting of the parties involved in the real estate transaction at which the transaction documents are signed and the deed and money are transferred. The closing process is sometimes called passing papers because, to the casual observer, that is primarily what happens at this meeting. In some states, primarily west of the Rocky Mountains, the closing or settlement procedure is handled through escrow. Escrow is a short-lived trust arrangement. If escrow is used, sellers and buyers usually do not meet face to face.

Steps to Closing

The settlement agent (closing agent or escrow officer) follows instructions and holds the documents and money until all of the terms, conditions, and contingencies have been met. If all is in order, the lender funds the loan and sends the proceeds to the closing agent. Buyers send their money to the closing agent as well. After that, closing statements are prepared and delivered, deeds are recorded, and money is paid to the proper parties.

The goal of the closing meeting is to transfer ownership of the property to the buyer and pay the seller for the property. To accomplish this goal, the paperwork brought to the meeting must be prepared, inspected, corrected if needed, approved, signed if necessary, and exchanged as required.

Preparation

In preparation for closing, the closing agent conducts a title search and obtains certificates of estoppel to verify outstanding balances on loans, liens, and encumbrances. The closing agent uses the sales contract, invoices submitted by various third parties (appraisers and inspectors), and instructions from the lender to prepare the documents. In escrow states, escrow instructions are prepared based on these documents. Escrow instructions are the written authorization to the escrow holder or title company to carry out the direction of the parties involved in the transaction. Prior to closing, buyers and sellers approve the estimated settlement statement, which details the allocation of the money.

Inspection

At the closing, each party reviews the documents that are of interest to his or her side. For instance, the buyer’s side examines the long list of documents that the seller’s side brings and the lender’s representative reviews the documents that assure the security of the title.
Approval & Exchange

Approval and the exchange of the documents and checks are interwoven. This is because, for legal reasons, certain events need to take place before others. For instance, the buyer must be in possession of the property in order to pledge it for the new mortgage. The relevant documents are recorded to ensure that the sale is legally documented. The seller gives the buyer the deed, keys to the property, and any other relevant items such as garage door openers.

Roles of Closing Participants

The people who are present at a closing meeting vary from state to state. Sometimes it even varies from one region of a state to another. The closing agent, seller, buyer, and real estate agents generally attend the real estate closing. Sometimes the title officer, loan officer, and attorneys for the buyer and/or seller also attend. When the principals’ agents and attorneys attend, they are not neutral third parties. Agents and attorneys attend the closing meeting to represent their client’s interests.

Real Estate Agents

The real estate agent’s role at closing is to be as prepared as possible to represent the client’s best interests. An agent must understand the roles of the various players and the documents that are required.

The agent or agents must be sure the buyer and seller are aware of what may occur in the closing meeting and what roles they will play. The real estate agent for each party must also see that the closing agent has access to all needed information so the transaction can close without problems.

Seller & Seller’s Attorney

In states that “pass papers” or have closing meetings rather than closing escrow, the seller or the seller’s attorney must prepare the paperwork that ensures a smooth transfer of ownership and answer questions regarding the status of the property.

Documents Needed for the Closing Meeting

Deed: A warranty deed is the most common deed used for this purpose, but others (such as a grant deed) are also used to transfer ownership.

Survey: A survey shows the property’s boundaries, improvements, and any encroachments. The buyer will likely require that major encroachments be corrected before closing.

Property Tax Bill: By bringing both the bill (if available) and a receipt to show any payment, the new owner will be able to see how much is owed. If the tax bill is not yet available, the taxes are estimated to close the transaction. Usually both parties agree that if the actual
taxes are significantly different from the estimated taxes, then an adjustment can be made after the actual figures become available.

Homeowner’s Insurance Policy: Lenders often require that this type of insurance be carried.

Title Insurance Policy: Lenders typically require this type of insurance to protect them from claims of ownership by people other than the buyer. It is highly recommended that buyers obtain an owner’s title insurance policy.

Abstract of Title: If title insurance is not used, the seller is responsible for either bringing the abstract of title, which is a compilation of all the documents that affect the title to a property, or inviting the abstracter to the meeting.

Flood Insurance Policy: Lenders may request this type of insurance for properties that are located on flood plains.

Termite Inspection Certificate: Some lenders may require this certificate. It is also legally required in certain areas.

Water and Sewer Certification: Properties that are not connected to public facilities must have a certificate that indicates that they have a private water source and sewage disposal system.

Building Code Compliance Certificate: Some areas require that a property be inspected before sale to ensure that it conforms to all current building codes.

Certificate of Occupancy: New homes must have a certificate of occupancy that the city supplies to the builder.

Offset Statement: If there is an existing lien against the property, this statement indicates the balance due.

Beneficiary Statement: This lender’s statement cites important information about the trust deed, including the unpaid balance, monthly payment, and interest rate.

Bill of Sale for Personal Property: If any personal property is being sold with the property, the seller should supply this document to show that the item is being included with the sale of the property.

Specific documents are needed if the property being sold is a shared ownership property such as a condominium or an income-producing property.

Homeowners’ Association Documents

- Restrictions
- Bylaws
- Articles of Incorporation
- Reserve Fund Report
- Management company contract or name
Documents Needed for an Income Property

- Current leases
- Rent schedules
- Lists of current expenditures
- Letter to be sent to current tenants to inform them of the upcoming change in ownership

Buyer & Buyer’s Attorney

The buyer’s primary responsibility is to have the money available to pay for the property at closing. The buyer must also inform the lender of when and where the closing meeting will occur. The buyer and his or her agent must complete certain obligations before the meeting.

Tasks That Must Be Complete Prior to the Meeting

- Complete any major contingencies that are present in the contract of sale and are the responsibility of the buyer. These might include arranging for new financing or getting approval to assume a loan.
- Inform the lending institution of the name of the closing agent and give approval to have borrowed funds delivered there upon request.
- If needed, deposit additional funds required to pay for property and closing costs with the closing agent.

Lender

When buyers obtain financing to purchase the property, the lender wire transfers the amount of the loan or prepares a cashier’s check to be presented at the meeting. In addition, the lender creates a note and mortgage for the buyer to sign.

Title Insurer or Title Abstracter

If a title insurance policy is being issued, the representative from the title company must bring information that provides the status of the property’s title to the closing meeting. If title insurance is not being issued, a title abstracter attends the meeting to provide information about the property’s chain of title and any liens against the property.
Marketability of Title

When a home is being purchased, a thorough search of the title must be completed to see if there are any liens, claims of ownership, or other outstanding judgments against the property, such as back taxes.

Buyers, sellers, lenders, and real estate brokers all rely on title insurance companies for chain of title information and policies of title insurance. The goal of title insurance companies is to ensure a clear, marketable title of property. **Marketable title** is a saleable title that is reasonably free from risk of litigation over possible defects.

Over the years, determining marketable title has gone through several phases such as abstract of title, certificate of title, guarantee of title, and title insurance. Under the old doctrine of *caveat emptor*, “let the buyer beware”, the buyer had the final responsibility to verify title of a property prior to purchasing it. As a result, many buyers lost their investment.

**Title insurance** is insurance that protects the policyholder from losses due to a problem in the chain of title. Typically, both the owner and the lender take out separate policies. Often, the previous owner pays for a new owner’s policy and the buyer pays for the lender’s policy.

Abstract of Title

Before reliable histories of properties came into existence, abstractors investigated the status of title to property. They searched available records and pertinent documents and prepared an abstract of title. An **abstract of title** is a written summary of all useful documents discovered in a title search. The abstract of title, together with an attorney’s opinion of title of the documents appearing in the abstractor’s chain of title, was the source of our earliest basis for establishing marketable title. The **chain of title** is the public record of prior transfers and encumbrances that affect the title of a parcel of land. An **opinion of title** is a written statement by an
attorney or title agent that states whether the property is encumbered or has clear and marketable title.

Over time, the abstracts and references to the recorded information were accumulated. Information regarding the property was organized in lot books and information affecting titles was organized in general indices. In time, these records became known as **title plants**. The abstract company used these title plants to supply interested parties with a certificate of title. This stated that the property was properly vested in the present owner and subject to noted encumbrances.

### Title Insurance

Title insurance was created in response to the need for reliable assurance of title combined with an insurance against loss caused by errors in searching records and reporting the status of title. The title insurance company uses the title plant to conduct the most accurate search of the public records possible (county recorder, county assessor, county clerk, and the federal land office) to make sure the chain of title is correct. If there is a missing connection in a property’s history or ownership (i.e., if a deed was recorded in error or is incomplete), it clouds the title. Any problems that arise may be corrected during the transaction period so the new owner gets a clear title.

The title company must determine insurability of the title as part of the search process that leads to issuance of a title policy. A marketable title is guaranteed because of title insurance and a new owner is protected against recorded and unrecorded matters. If someone challenges the title, the title insurance company defends the title and pays the losses covered under the policy.

### Title Insurance Policies

The main benefit of title insurance is that it provides protection against matters of record and many non-recorded types of risks, depending on the coverage purchased. Policies for lenders and owners are the main types of title insurance policies. Each policy is designed to suit the needs of the purchaser.

#### Lender’s Title Insurance Policy

The lender’s policy is designed to benefit the lender. Some lenders require a title company to provide them with a 24-month chain of title in order to see if the property has been subject to flipping. Lenders look at the flipping of properties very closely. If a property is flipped too many times, the lender may decline the loan.
Example: There are reported cases of properties being sold to buyer A, then to buyer B, then to buyer C, then “flipped” back to buyer A, and then to buyer D. All the parties were related in some manner and this fraudulently drove the price and demand up for the property.

Lender’s policies generally have extended coverage. Lender’s policies cover only the amount of money still owed on the loan. Therefore, lender’s policies decline in coverage as the buyer pays off the mortgage. If the buyer completely pays off the mortgage, the lender’s title insurance policy ceases to exist. If the lender sells the loan to another institution, the lender’s title insurance can be assigned to the new holder of the loan. At closing, the buyer typically pays for the lender’s title insurance policy.

**Owner’s Title Insurance Policy**

The owner’s title insurance policy is designed to benefit the owner and his or her heirs. The coverage is usually a standard policy but owners can purchase an extended coverage policy at extra cost. The coverage cited in an owner’s policy is in force for the duration of the policy. Owner’s policies cannot be assigned. Typically, the seller of a property pays for the new owner’s title insurance policy at closing.

**Types of Title Insurance Coverage**

The American Land Title Association (ALTA) is the national trade association for title insurance companies and title insurance agents. The American Land Title Association (ALTA) forms are used almost universally throughout the nation. The two types of title insurance coverage are (1) standard and (2) extended.

**Standard Coverage Policy**

A standard title insurance policy is usually issued to homebuyers. No physical inspection of the property is required and the buyer is protected against all recorded matters and certain risks such as forgery and incompetence. The title company does not do a survey or check boundary lines when preparing a standard title insurance policy.

**Losses Protected by Standard Title Policies**

- Matters of record
- Off-record hazards such as forgery, impersonation, or failure of a party to be legally competent to make a contract
- The possibility that a deed of record was not delivered with intent to convey title
- Losses that might arise from the lien of federal estate taxes, which becomes effective without notice upon death
- Expenses incurred in defending the title
Losses Not Protected by Standard Title Policies

- Defects in the title known to the holder to exist at the date of the policy but not previously disclosed to the title insurance company
- Easements and liens that are not shown by public records
- Rights or claims of persons in physical possession of the land but whose claims are not shown by the public records
- Rights or claims not shown by public records but which can be discovered by physical inspection of the land
- Mining claims
- Reservations in patents or water rights
- Zoning ordinances

Extended Coverage Policy

All risks covered by a standard policy are covered by an extended coverage policy. An extended coverage policy also covers other unrecorded hazards such as outstanding mechanics’ liens, tax liens, encumbrances, encroachments, unrecorded physical easements, facts shown by a correct survey, and certain water claims. Also covered are rights of parties in possession, including tenants and owners under unrecorded deeds.

Property Tax Issues

Most people have questions about taxes in a real estate transaction. Taxation is an indirect, yet important, factor that affects the value of property.

In this section, we will see how taxes affect buying and selling real estate. As a student, use this unit for general knowledge about real estate taxation. However, always refer your clients to an expert for their own tax information as well as current tax laws.

Property Taxes

The idea of land taxation began in 1086 in England when all land and resources were compiled into the Domesday Book that William the Conqueror commissioned. Taxation was based on the notion that taxes should be assessed according to an owner’s ability to pay. At that time, since most people’s income came almost entirely from products of their land, ability was reliably determined by how much and how good the owner’s agricultural holdings were. Therefore, land became the basis for determining the amount of tax imposed.

Property taxes are paid in arrears (at the end of each tax period). Paying in arrears is payment at the end of a period for which payment is due. It is the opposite of paying in advance.
When a property tax is assessed against a property, a property tax lien for that amount is placed on the property. This type of lien is superior to all other liens and cannot be cleared by a foreclosure. Property taxes are assessed differently in each state.

**Assessment & Collection of Taxes**

Real property is taxed at the local level through ad valorem property taxes, special assessments, and transfer taxes. *Ad valorem* means according to value.

A *taxing authority* is any organization that is legally able to set (levy) and collect a tax. The first taxing authority that most real estate owners think of is their local government, but a piece of real estate may also be within districts that belong to other taxing authorities.

**Other Taxing Authorities**

- Local governments - taxes to pay for schools, police and fire departments, street maintenance, public parks, and libraries, among other expenses
- School districts - taxes to support schools
- Drainage districts - taxes for drainage infrastructure construction and maintenance
- Sanitary districts - taxes for the construction, maintenance, and operation of sewage treatment plants
- Recreational districts - taxes for the construction, maintenance, and operation of parks, playgrounds, baseball diamonds, tennis courts, recreation centers, marinas, and trails

**Immune & Exempt Property**

All property within the locality of the taxing authority, whether state or local government, is taxed unless specifically immune or exempt. *Immune properties* typically include those owned by governments, such as schools, parks, military bases, and government buildings. *Exempt properties* include hospitals, homesteads, and property that belongs to religious organizations such as churches or synagogues. Property tax exemptions are discussed in detail later in this unit.

**Review – Immune Property**

- Governments are typically exempt from paying property tax on their own property. No property taxes are paid on military bases, public water treatment plants, public dumps, public roads, city halls, public schools, libraries, or parks.
Review – Exempt Property

- Most states offer a property tax exemption to religious or charitable organizations.
- Cemeteries and hospitals are often exempt from property taxes.
- Owners of homesteaded property are partially exempt. The taxable value of a property is determined by the assessed value minus any exemptions.

Special Assessments

When specific improvements are needed to benefit a certain area—such as underground utilities, sewers, or streets—special assessments are levied to pay for the improvements. Special assessments are taxes used for specific, local purposes. In contrast, property taxes are used to operate the government in general.

Special assessment liens are placed on the properties involved and are usually paid at the same time as property taxes. The liens created by special assessments are equal in priority to general tax liens.

Additionally, a public agency or a group of homeowners can initiate improvements that result in special assessments. The costs of the improvements are divided equally or proportionally (often on a per-front-foot basis) among the homeowners. When computing using the front foot method, consider that the burden is shared with the neighbor across the street.

Closing Costs and Statements

Closing costs are the expenses buyers and sellers normally incur in the transfer of ownership of real property that are over and above the cost of the property. These costs appear on the seller’s and buyer’s closing statements. The closing statement is an accounting of funds made to the sellers and buyers individually. It shows how all closing costs, including prepaid and prorated expenses, are allocated between the buyer and seller. In most transactions, the seller pays for title insurance and any delinquent assessment liens that show up as debits.

A real estate agent should be able to compute the costs and competently explain all costs and expenses to his or her clients. These costs do not include the cost of the property.

In order to complete the real estate transaction, closing costs must be paid. The buyer and seller give the closing agent instructions regarding prorations and other accounting that must be done at the close of the transaction.

Closing costs are either prorated or allocated. Do not confuse allocation with proration. Allocation assigns a cost (generally one not yet spent) to
either the seller or the buyer. **Proration** divides a cost (most often one that has already been paid) between the two parties. It is up to the parties to determine if a cost is allocated or prorated. Usually, property tax and interest are prorated at closing.

**Prorated Costs**
Proration is the division and distribution of expenses and/or income between the buyer and seller of property as of the date of closing. Prorations are typically calculated using the seller’s last full day of ownership and the buyer is charged for the closing day. Prorations are typically based on one of two methods: a 365-day year method or a 30-day month method. Frequently, the method that is used is stated in the purchase contract.

**Proration Calculations**
- Using the 365-day method, the annual cost is divided by 365 days. This gives a daily rate. The daily rate is then multiplied by the number of days. This equals the amount due.
- Using the 30-day month method, divide the annual cost by 12 months then by 30 days. This gives a daily rate. The daily rate is then multiplied by the number of buyer or seller days, which then equals the amount due.

**Property Tax**

**Property tax** is the money owed to the local or state government for services used by the homeowner. Property taxes are often prorated. If the seller prepaid property taxes, he or she expects to get the unused portion back. This shows up as a credit.

Example: Closing is October 31 and the seller has not paid the property tax of $3,650, which is due November 1. To calculate the amount owed, prorate the tax according to the number of days in the tax year each party owned the property. In this example, the buyer is responsible for the taxes as of the closing date.

1. Calculate the cost of taxes per day.
   \[ \frac{3,650}{365 \text{ days}} = 10.00 \text{ daily} \]
2. Count the days during the tax period in question when seller owned the property.
   January 1 – October 30 = 303 days
3. Multiply the number of days the seller owned the property by the cost of taxes per day.
   \[ 303 \times 10.00 = 3,030 \text{ owed by seller} \]
4. Subtract $3,030 from the total tax charged to buyer.
   \[ 3,650 - 3,030 = 620 \text{ owed by buyer} \]
Interest on Loan Assumption

When a buyer assumes an existing loan, the interest is shown on the closing statement as a debit to the seller and a credit to the buyer.

Assumable loans are not very common in today’s market. However, it is important to understand how to calculate prorated interest on an assumed loan. Because mortgage interest is paid in arrears—at the end of a time period—the seller credits the buyer for his or her share of the interest.

Escrow (Impound) Account

An escrow account, which is sometimes referred to as an impound account, is a trust account for funds set aside for future, recurring costs relating to a property, such as payment of property taxes and hazard insurance. Usually the lender determines whether there will be an impound account, but sometimes the buyer decides on the use of an impound account and the closing agent is given instructions regarding how to handle the credits and debits.

Allocated Costs

The list of costs to be allocated can become quite long. Generally, the costs fall into the categories of inspections, required retrofits, and fees. Some items that may be on the list include transfer taxes, recording fees, and hazard and title insurance.

Transfer Taxes

Transfer taxes are paid to state or local governments to transfer the ownership of property from one owner to another. Transfer taxes allow the government to assess property values. Transfer tax may also be known as documentary stamp tax or conveyance tax. Most of the time, it is paid by the seller. The buyer normally pays the state taxes associated with the financing.

A transfer of property can involve three transfer taxes, each with its own set of calculations. The three taxes are the documentary stamp tax on deeds, the documentary stamp tax on notes, and the intangible tax on new mortgages.

Stamp Tax on Deeds

The stamp tax on deeds is required whenever real property is transferred from one owner to another. In order to establish accurate tax assessments, this tax allows governments to secure data about the fair market value of real properties in their jurisdictions.

Many transactions are exempt from this tax. Some exempted transactions include transfers between a husband and wife or parent and child, gift deeds, and tax deeds.
Recording Fees

**Recording fees** are monies paid to government agencies, typically the county, to legally record documents that concern the property. The buyer often pays the recording fees.

Title & Hazard Insurance

Title insurance protects the policyholder from losses due to a problem in the chain of title. Typically, both the owner and the lender take out separate policies. Often, the previous owner pays for a new owner’s policy and the buyer pays for the lender’s policy.

**Hazard insurance** is a property insurance policy that protects both owner and lender against physical hazards to property such as fire and windstorm damage. Lenders require hazard insurance that covers the lesser of 100% of the insurable value of the improvements (established by the property insurer) or the outstanding loan on the property provided it is at least 80% of the insurable value of the improvements.

Many casualty insurance companies provide hazard insurance. In most cases, the lender is the loss payee on the policy and receives the proceeds on a claim. The proceeds are then used to pay for the repairs. In addition, depending on the location of the property, the lender may require flood insurance.

What Are Credits & Debits?

A **credit** is the reduction or elimination of an asset or expense. A credit is usually recorded on the right side of a column on a closing statement. A **debit** shows the amount owed.

Typically, the buyer and seller negotiate the allocation of these costs in the sale contract. Usually, the person who must sign the document is the one who pays the fee for its preparation. Therefore, the seller pays for the preparation of the deed and the buyer pays for the preparation of the loan documents. A particular cost may be paid in full by either the buyer or the seller, split evenly, negotiated between the two parties, or prorated. The closing agent assigns the credits and debits according to the principal’s instructions.

Seller’s Statement

The seller’s statement is a record of the financial proceeds the sellers receive upon the transaction’s closing.

**Seller’s Credits**
- Amount of the total consideration or sales price
- Any prepaid property taxes
- Prepaid monthly property owner’s association dues
- interest on loan seller owes will reduce payoff if prepaid
**Seller’s Debits (Only if contracted to be paid by seller)**
- Loan payoff on existing loan plus any interest charges
- Broker’s commission
- Title insurance (owner’s policy)
- Abstract or title search
- Settlement or escrow fee (seller’s share)
- Legal fees
- Prepayment penalty
- Documentary transfer tax (deed)
- Pest control inspection fee
- Pest control work
- FHA or VA points
- Pest inspection report
- Home warranty plan

**Buyer’s Statement**

The buyer’s statement is a record of costs and credits incurred for the purchase of the property.

**Buyer’s Credits**
- Down payment
- Binder deposit (good faith deposit)
- Amount of new loan
- Assumed loan
- Prorated taxes
- Prorated rents
- Security deposits held by sellers
- Balance from buyer needed to close

**Buyer’s Debits for Non-Recurring Costs**
- Purchase price
- Title insurance (lender’s policy)
- Settlement or escrow fee (buyer’s share)
- Legal fees
- Loan application fee
- Underwriting fee
- Loan fee/points
- Appraisal fee
- Tax service
- Credit report
- Notary fee
- Recording fees
- Assumption fee
• Documentary transfer tax (note, mortgage)
• Pest control inspection (according to agreement with sellers)
• Survey

**Buyer’s Debits for Recurring Costs**
• Hazard insurance
• Trust fund or impound account
• Prorated taxes (if prepaid by sellers beyond recordation)
• Prorated interest (if charged in arrears)

**Types of Settlement Statements**

The **closing statement** is an accounting of funds made to the sellers and buyers individually. The closing agent must complete closing statements for every real estate transaction. The sellers and buyers are both credited and debited for their agreed-upon share of costs. Generally, a real estate agent attends the closing meeting. As a sales agent, you should understand closing statement calculations because you may be required to explain the costs outlined on these statements.

Some of the settlement statements used for residential real estate transaction are the CFPB Closing Disclosure, a standardized ALTA settlement statement, the HUD-1 Settlement Statement, or a generic settlement statement prepared by the escrow company. Since an all-cash sale is not covered by the CFPB, an escrow officer may use any settlement statement he or she chooses—including the CFPB Closing Disclosure.

**TILA-RESPA (TRID) Closing Disclosure**

The Closing Disclosure created by the Consumer Financial Protection Bureau (CFPB) must be used for real estate transactions financed using closed-end residential loans, construction-only loans, vacant-land loans, and 25-acre loans. Additionally, the Closing Disclosure must be used for any federally related residential mortgage loans subject to RESPA (which will include most mortgages).

RESPA defines **federally related mortgage loans** as loans (or refinances) secured by a first or subordinate lien on a one-to four-family residential real property. The definition also includes loans made by or insured by an agency of the federal government and any loans made by lenders that are regulated by or whose deposits or accounts are insured by any agency of the federal government. [12 CFR §1024.2].

As you can see, this definition covers nearly all residential real estate loans obtained from a lender. Obviously, the Closing Disclosure will be the most frequently used settlement statement for 1-4 residential transactions.
ALTA Settlement Statements
The American Land Title Association (ALTA) developed four standardized ALTA Settlement Statements for title insurance and settlement companies to use to itemize all the fees and charges that both the homebuyer and seller must pay during the settlement process of a housing transaction.

If a residential transaction does not involve a lender, the ALTA Settlement Statement Cash, could be used for an all-cash sale.

HUD-1 Settlement Statement
The HUD-1 Settlement Statement is still used for transactions involving home-equity lines of credit (HELOCs), reverse mortgages, mortgages secured by a mobile home or a dwelling that is not attached to real property.

Loan Closing Procedures
Below is a brief explanation of a typical funding process. In order to start the funding process with the mortgage company, proper documentation must be sent to the lender or underwriter before each individual loan is funded.

1. Request for purchase detailing summary of transaction from mortgage company
2. Required documents to fund
   • Completed loan application (Form 1003)
   • Appraisal - first two pages
   • Firm Commitment by D.E. Underwriter (FHA), VA Loan Analysis by VA Automatic Underwriter (VA), Investor Underwriter, LP or DU approvals from authorized channels (Fannie Mae, Freddie Mac)
   • Copy of Borrower's credit report
   • Insured closing letter in the name of the originator from the title company
   • Wiring instructions
   • Copy of hazard insurance policy or binder of coverage
   • Flood certification
   • Mortgage insurance (MMI or PMI) or VA mortgage guaranty
   • VA certificate of eligibility (if applicable)
   • Purchase commitment from investor - investor lock
3. Funds are wired directly to closing agent along with specific funding instructions
4. Closing agent faxes a copy of signed note on the date of the closing and overnights the following documents within 1 business day immediately preceding settlement.
   • Original signed note
   • Certified copy of deed of trust
   • Copy of title commitment
   • Copy of the Closing Disclosure or the HUD-1
   • Copy of Truth-In-Lending Act

Endorsement & Flow of Documents
1. Original signed note is to be sent directly from closing agent back to bank; note is to be endorsed in blank
2. Original Assignment of Deed of Trust in blank, plus assignment to investor is sent with the note to closing agent

Collection of the Note
3. Upon receipt of note, a bailee letter is prepared and sent with note to the investor for payment
4. Loan is booked at the negotiated rate

Payoff Procedures
5. Funds wired to the closing agent from the investor
6. Borrower sent payoff information
7. Payoff calculated from date of closing to date of receipt of wire
8. Loan for payoff amount credited at the negotiated rate
9. Appropriate fees deducted from the wire and deposited into the mortgage company loan income account
10. Mortgage company operating account credited for the remainder of the wire
11. Copies made of the transaction are faxed or e-mailed to the mortgage company

After all information that is required in the underwriting process is received, processed, and analyzed, and the security for the loan is determined to be sufficient, the decision is made to accept or reject the loan. This decision is made by the person or loan committee whose job is to decide which loans to fund. Once approved, the loan goes to the final stage of the real estate loan approval process, the loan closing, at which time necessary documents are prepared and executed.

At closing, the borrower receives the package of closing documents, some of which must be signed before a notary. The borrower signs the note and security instruments (deed of trust or mortgage) and various accompanying disclosures. Once the borrower has executed all documents, the loan is funded and the deed of trust or mortgage (as applicable) is recorded.
RESPA Settlement Disclosures

Lenders who make real estate loans and brokers who arrange these loans must comply with various federal and state disclosure laws and regulations. Underwriters must be aware of these laws and act in accordance with them.

Certain disclosures that protect consumers from unfair lending practices are required at different times during a loan transaction. They are the Special Information Booklet (not necessary for refinances), the Loan Estimate (October 3, 2015), and the Mortgage Servicing Disclosure Statement. After October 3, 2015, the Good Faith Estimate and the Truth-in-Lending Disclosure Statement will only be used for certain transactions, such as reverse mortgages.

Disclosures at Settlement/Closing

The Closing Disclosure or the HUD-1 Settlement Statement shows the actual settlement costs of the loan transaction. Lenders must ensure that BORROWERS receive the Closing Disclosure no later than 3 business days before consummation (the day the loan closes). [12 CFR §1026.19(f)(1)(ii)]. The settlement agent is responsible for preparing and providing the Closing Disclosure to the SELLER at or before consummation. [12 CFR §1026.19(f)(4)(ii)]. If the HUD-1 is used, the settlement statement should be available for inspection by the borrower/buyer and seller at or before the closing. [12 USC §2603(b)].

Separate forms may be prepared for the borrower and the seller. When it is not standard practice for both the borrower and seller to attend the settlement, the final Closing Disclosure or the HUD-1 is mailed or delivered as soon as is practical after settlement.

The lender may require a borrower to maintain an escrow account with the lender to ensure the payment of taxes, insurance, and other items. This typically occurs when the borrower’s first loan exceeds 80%. HUD regulations limit the maximum amount that a lender can require a borrower to maintain in the escrow account. If the lender does require it, the Initial Escrow Statement or Estimated Closing Statement itemizes the estimated taxes, insurance premiums, and other charges to be paid from the escrow account during the first 12 months of the loan. It lists the escrow payment amount and any required cushion. Although the statement is usually given at settlement, the lender has 45 days from settlement to deliver it.

Disclosures After Settlement

Loan servicers must deliver an Annual Escrow Statement to borrowers once a year. The Annual Escrow Statement summarizes all escrow account deposits and payments during the servicer’s 12-month
computation year. It also notifies borrowers of any shortages or surpluses in the account and advises them of the course of action taken to correct the overage or shortage. A shortage in an escrow account can occur if insurance rates or tax rates increase on the property. If the account is short, the lender may increase the borrower’s monthly home loan payment to accommodate the shortage. Under RESPA statutes, the lender is allowed to maintain a cushion equal to one-sixth of the amount of items paid out of the account, or approximately 2 months of escrow payments. If state law or loan documents allow for a lesser amount, the lesser amount prevails.

A Servicing Transfer Statement is required if the loan servicer sells or assigns the servicing rights to a borrower’s loan to another loan servicer. Generally, the loan servicer must notify the borrower 15 days before the effective date of the loan transfer. As long as the borrower makes a timely payment to the old servicer within 60 days of the loan transfer, the borrower cannot be penalized. The notice must include the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments.

Summary

Settlement, or closing, is the final meeting of the parties involved in the real estate transaction at which the transaction documents are signed and the deed and money are transferred. In some states, primarily west of the Rocky Mountains, the closing or settlement procedure is handled through escrow. Escrow is a short-lived trust arrangement. The goal of the closing meeting is to transfer ownership of the property to the buyer and pay the seller for the property.

The people who are present at a closing meeting vary from state to state. Sometimes it even varies from one region of a state to another. The closing agent, seller, buyer, and real estate agents generally attend the real estate closing. Sometimes the title officer, loan officer, and attorneys for the buyer or seller also attend. When the principals’ agents and attorneys attend, they are not neutral third parties. Agents and attorneys attend the closing meeting to represent their client’s interests.

Buyers, sellers, lenders, and real estate brokers all rely on title insurance companies for chain of title information and policies of title insurance. The goal of title insurance companies is to ensure a clear, marketable title of property. Marketable title is a saleable title that is reasonably free from risk of litigation over possible defects. Title insurance is insurance that protects the policyholder from losses due to a problem in the chain of title. Typically, both the owner and the lender take out separate policies.

Property tax is the money owed to the local or state government for services used by the homeowner. Property taxes are often prorated. If the
seller prepaid property taxes, he or she will expect to get the unused portion back. This shows up as a credit. Property taxes are paid in arrears (at the end of each tax period). Paying in arrears is payment at the end of a period for which payment is due. It is the opposite of paying in advance.

**Closing costs** are the expenses buyers and sellers normally incur in the transfer of ownership of real property that are over and above the cost of the property. These costs appear on the seller’s and buyer’s closing statements. The **closing statement** is an accounting of funds made to the seller and buyer individually. It shows how all closing costs, including prepaid and prorated expenses, are divided between the buyer and seller. In most transactions, the seller pays for title insurance and any delinquent assessment liens that show up as debits. Closing costs are either prorated or allocated. **Allocation** assigns a cost (generally one not yet spent) to either the seller or the buyer. **Proration** divides a cost (most often one that has already been paid) between the two parties.

In order to start the funding process with the lender, proper documentation must be sent to the closing agent before each individual loan is funded. After all required information in the underwriting process is received, processed, and analyzed, and the security for the loan is determined to be sufficient, the decision is made to accept or reject the loan.
Unit 11
California Mortgage Licensing Requirements

Introduction

California has two agencies that license individuals and business entities to originate residential mortgage loans—the California Bureau of Real Estate (CalBRE) and the California Department of Business Oversight (DBO). These two agencies issue three (3) different types of mortgage company licenses.

The California Bureau of Real Estate offers company licenses (i.e., sole proprietorship, corporation), branch office licenses, and individual licenses. These licenses must have the Nationwide Mortgage Licensing System (NMLS) Endorsement.

Licenses Issued by the California Bureau of Real Estate (CalBRE)

- Real Estate Broker License MLO Endorsement (Sole Proprietor - Company)
- Real Estate Corporation License MLO Endorsement
- Branch Office License MLO Endorsement
- Real Estate Broker License MLO Endorsement (Individual)
- Real Estate Salesperson License MLO Endorsement

The Bureau of Real Estate regulates real estate activities through the Business and Professions Code (BPC), Sections 10000 through 11506, known as the Real Estate Law. The section of the Real Estate Law that pertains to mortgage loan originators is found in Division 4 commencing with Section 10166.01. [CA B&P Code §§10166.01-10166.17] The regulations are contained in Chapter 6, Title 10 of the California Code of Regulations, commencing with Section 2758. [10 C.C.R. §2758, et seq.]

The California Department of Business Oversight (DBO) offers two different types of mortgage company licenses, the California Residential Mortgage Lender License (CRML License) and the California Finance Lender License (CFL License).
Licenses Issued under the California Residential Mortgage Lending Act (CRMLA)

- Residential Mortgage Lending Act License
- Residential Mortgage Lending Act License (Branch)
- Residential Mortgage Loan Originator License (CRML License)

The California Residential Mortgage Lending Act (CRMLA) is contained in Division 20 of the California Financial Code, commencing with Section 50000-50006. The regulations are contained in Subchapter 11.5 of Chapter 3 of Title 10 of the California Code of Regulations, commencing with Section 1950.003. [10 C.C.R. §1950.003, et seq.]

Licenses Issued under the California Finance Lenders Law (CFLL)

- Finance Lenders Law License
- Finance Lenders Law License (Branch)
- Mortgage Loan Originator License (CFL License)

The California Finance Lenders Law (CFLL) is contained in Division 9 of the California Financial Code, commencing with Section 22000. [Financial Code §22000 et seq.]. The regulations are contained in Chapter 3, Title 10 of the California Code of Regulations, commencing with Section 1404. [10 CCR §1404, et seq.]

Each license type has different minimum net worth required for approval. **Net Worth** is the company’s assets minus the company’s liabilities.

1. The CalBRE License has no minimum net worth requirement.
2. The CRML License has a $250,000 minimum net worth requirement, which must be audited by a CPA.
3. The CFL License has a $250,000 minimum net worth requirement if the company is funding residential mortgage loans and $50,000 if the company is brokering residential mortgage loans.

   If the company is only originating commercial mortgage loans and non-secured loans, then the minimum net worth for the CFL License is only $25,000. Financial statements for CFL lenders do not need to be audited.

All three types of company licenses (CalBRE, CRMLA, and CFLL) allow the companies to broker, bank/lend, or service residential mortgages. The CalBRE license and the CFL License both allow a company to originate commercial mortgage loans. The CRML License is the only license type that allows a company to **sub-service residential mortgages**, which means to service loans that are owned by another company. The CFL
License is the only license that allows a company to originate non-secured commercial or personal loans. The CFL License only allows CFL brokers to broker mortgage loans to CFL Lenders. This means that a CFL broker cannot broker mortgage loans to CalBRE companies, CRML companies, or federally or state chartered banks, unless those companies also hold a CFL License. However, a CFL lender can sell mortgage loans to any company. The restriction solely applies to brokering loans.

This Unit provides an overview of the CA-DBO licensing and focuses solely the pertinent provisions of the California Financial Code regarding CA-DBO licensing.

**Learning Objectives**

After completing this Unit, you should be able to:

- differentiate among the types of mortgage loan originator licenses in California.
- recognize exemptions from licensing under the CRMLA or the CFLL.
- recall the licensing requirements under the CRMLA.
- recall the licensing requirements under the CFLL.

**Mortgage Loan Originator Licensing**

Any person who wants to originate residential mortgage loans in California must have a mortgage loan originator license.

A **mortgage loan**, **residential mortgage loan**, or **home mortgage loan** means a federally related mortgage loan as defined by Regulation X in 12 CFR §1024.2 or a loan made to finance construction of a one-to-four family dwelling. [CA Fin.Code §50003 (p)]

According to 12 CFR §1024.2, a **federally related mortgage loan** means:

1. Any loan (other than temporary financing, such as a construction loan):
   - That is secured by a first or subordinate lien on residential real property, including a refinancing of any secured loan on residential real property, upon which there is either:
     - Located or, following settlement, will be constructed using proceeds of the loan, a structure or structures designed principally for occupancy of from 1 to 4 families (including individual units of condominiums and cooperatives and including any related interests, such as a share in the cooperative or right to occupancy of the unit); or
• Located or, following settlement, will be placed using proceeds of the loan, a manufactured home; and

• For which one of the following paragraphs applies. The loan:

  • Is made in whole or in part by any lender that is either regulated by or whose deposits or accounts are insured by any agency of the Federal Government;
  • Is made in whole or in part, or is insured, guaranteed, supplemented, or assisted in any way:
    • By the Secretary of HUD or any other officer or agency of the Federal Government; or
    • Under or in connection with a housing or urban development program administered by the Secretary of HUD or a housing or related program administered by any other officer or agency of the Federal Government;
  • Is intended to be sold by the originating lender to Fannie Mae, Ginnie Mae, Freddie Mac (or its successors), or a financial institution from which the loan is to be purchased by the FHA (or its successors);
  • Is made in whole or in part by a creditor that makes or invests in residential real estate loans aggregating more than $1,000,000 per year.
  • Is originated either by a dealer or by a mortgage broker; or
  • Is a reverse mortgage

2. Any installment sales contract, land contract, or contract for deed on otherwise qualifying residential property is a federally related mortgage loan if the contract is funded in whole or in part by proceeds of a loan made by any maker of mortgage loans specified in paragraphs (1)(ii) (A) through (D) of this definition.

3. If the residential real property securing a mortgage loan is not located in a State, the loan is not a federally related mortgage loan.

A mortgage loan originator is an individual who, for compensation or gain, or in the expectation of compensation or gain, takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan. [CA Fin.Code §50003.5.(a)].

The definition of mortgage loan originator does not include individuals who perform purely administrative or clerical tasks on behalf of a person meeting the definition of a mortgage loan originator.
Administrative or clerical tasks means the receipt, collection, and distribution of information common for the processing or underwriting of a loan in the mortgage industry and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan. The communication cannot include offering or negotiating loan rates or terms or counseling consumers about residential mortgage loan rates or terms. [CA Fin.Code §50003.5.(b)(1)].

**Mortgage Loan Originator License**

A person who provides services as a mortgage loan originator (MLO) in California under the CFLL or the CRMLA must apply for and receive a DBO mortgage loan originator license issued by the California Department of Business Oversight (DBO). All MLOs employed by finance lenders/brokers under the CFLL or residential mortgage lenders/servicers under the CRMLA must have MLO licenses.

These license types have different requirements for approval and allow different activities.

**Approved Activities**

- CRML MLOs can only broker to CRML-licensed companies, and to state and federally chartered institutions.
- CFL MLOs can only broker to CFL-licensed lenders.

**Qualifications for a DBO MLO License**

Every applicant for a mortgage loan originator license must take qualifying education and pass a written test. [10 CCR §1950.122.5.1].

**Education:** An applicant must complete at least 20 hours of MNLS-approved education that includes 3 hours of instruction on federal law and regulations, 3 hours of ethics (fraud, consumer protection, and fair lending), and 2 hours of training related to lending standards for the nontraditional mortgage product marketplace.

**Written Test.** An applicant for a MLO license must pass a written test developed by the NMLS and administered by a test provider approved by the NMLS within one year prior to the date of filing the application for, or the issuance of, a mortgage loan originator license.

Applicants must prove that they are financially responsible. This is achieved by the applicant authorizing the NMLS to obtain a current credit report. A person may be precluded from obtaining a MLO license if the personal history on the credit report includes any liens or judgments for fraud, misrepresentation, dishonest dealing, and/or mishandling of trust
funds, or any financial or professional conditions that indicate a pattern of dishonesty on the part of the applicant. [10 CCR §1950.122.5.2].

Application Process for a MLO License

Whether the person is applying for a license under the sponsorship of a CRMLA-licensed business or a CFLL-licensed business, ALL applications are made on **Form MU4** through the Nationwide Mortgage Licensing System (NMLS).

**Form MU4** is the uniform licensing form developed by the Nationwide Mortgage Licensing System and Registry for an individual mortgage loan originator license or registration, entitled “Uniform Individual Mortgage License/Registration & Consent Form.” [10 CCR §1950.003 (g) and 10 CCR §1404(j)].

The **Nationwide Mortgage Licensing System (NMLS)** is the official system for companies and individuals seeking to apply for, amend, renew, and surrender license authorities managed through NMLS by state agencies. The NMLS itself does not grant or deny license authority. [10 CCR §1950.003 (h) and 10 CCR §1404(k)].

Regardless of which type of mortgage loan originator license a person has, he or she must be employed or sponsored by a company licensed under the rules of the California Department of Business Oversight (DBO).

**Sponsoring** or **to sponsor** means to maintain an employment relationship between a mortgage loan originator and a mortgage lender, mortgage broker, or mortgage lender and broker where the mortgage loan origination activities of the mortgage loan originator are subject to the supervision and oversight of the mortgage lender, mortgage broker, or mortgage lender and broker. A licensed mortgage lender, mortgage broker, or mortgage lender and broker is the “**sponsor**” of a mortgage loan originator employed by, and subject to the supervision and oversight of, the mortgage lender, mortgage broker, or mortgage lender and broker. [10 CCR §1950.003 (i) and 10 CCR §1404(l)].

The California’s Residential Mortgage Lending Act

The **California Residential Mortgage Lending Act** (CRMLA), enacted in 1994, became operative in 1996. The law is administered and enforced by the California Department of Business Oversight (DBO) under the direction of the Commissioner of Business Oversight. The chief executive officer of the California Department of Business Oversight is the Commissioner. Regulations are promulgated by the Department’s Commissioner.
The CRMLA was enacted as an alternative to the existing laws licensing lenders under the California Finance Lenders Law, in order to provide mortgage bankers with a licensing law specifically directed at their primary functions of originating and servicing residential mortgage loans.

A **mortgage banker** is a company, individual, or institution that originates purchases, makes, sells, or services loans secured by mortgages on residential real property. Mortgage bankers use their own funds, (or funds borrowed from a warehouse lender) to fund mortgages.

**Makes residential mortgage loans** means processing, underwriting, or as a lender using or advancing one’s own funds, or making a commitment to advance one’s own funds, to a loan applicant for a residential mortgage loan. [CA Fin.Code §50003.(o)].

**Own funds** is:

1. cash, corporate capital, or warehouse credit lines at commercial banks, savings banks, savings and loan associations, industrial loan companies, or other sources that are liability items on a lender's financial statements, whether secured or unsecured, or

2. a lender's affiliate's cash, corporate capital, or warehouse credit lines at commercial banks or other sources that are liability items on the affiliate's financial statements, whether secured or unsecured.

Own funds does not include funds provided by a third party to fund a loan on condition that the third party will subsequently purchase or accept an assignment of that loan. [CA Fin.Code §50003.(t)].

**Residential real property** (or real estate) is real property located in California that is improved by a one-to-four family dwelling. [CA Fin.Code §50003.(v)].

After a mortgage is originated, a mortgage banker might retain the mortgage in portfolio or sell the mortgage to an investor. Additionally, after a mortgage is originated, a mortgage banker might service the mortgage or sell the servicing rights to a mortgage servicer. The distinguishing feature between a mortgage banker and a mortgage broker is that mortgage bankers close mortgages in their own names, using their own funds, whereas mortgage brokers facilitate originations for other financial institutions.

Unlike the California Finance Lenders Law, the CRMLA is specifically designed to authorize and regulate mortgage-banking activities. A license can be issued as a residential mortgage lender, a residential mortgage loan servicer, or both residential mortgage lender and residential mortgage loan servicer.
A **lender** is someone who is an approved lender for the Federal Housing Administration, Veterans Administration, Farmers Home Administration, Ginnie Mae, Fannie Mae, or Freddie Mac. A lender directly makes residential mortgage loans and makes the credit decision in the loan transactions. [CA Fin.Code §50003 (m)].

A **mortgage servicer** or **residential mortgage loan servicer** is someone who is an approved servicer for one of the entities listed above and directly services or offers to service mortgage loans. [CA Fin.Code §50003 (q)].

The CRMLA authorizes **Residential Mortgage Lender** (CRML) licensees to make **federally related mortgage loans**, to make loans to finance the construction of a home, to sell the loans to institutional investors, and to service such loans. Licensees are authorized to purchase and sell federally related mortgage loans and to provide contract underwriting services for institutional lenders. Licensees are authorized to service any federally related mortgage loan regardless of whether they make the loan or purchase a servicing portfolio.

A licensed CRMLA lender is also authorized to provide brokerage services to a borrower, by attempting to obtain a mortgage loan on behalf of the borrower from an institutional lender.

**CRMLA Lenders must use Licensed MLOs**

A CRMLA-licensed mortgage lender or servicer may not make or broker residential mortgage loans unless the loans are negotiated by or applied for through licensed mortgage loan originators.

A CRMLA-licensed lender engaged in mortgage brokering activities must be sure that every mortgage loan originator employed or compensated by that entity obtains and maintains a CRML mortgage loan originator license or has a CalBRE MLO license endorsement.

Any mortgage loan originator whose license or license endorsement has lapsed cannot work or broker loans for a CRMLA-licensed lender. [CA Fin.Code §50002.5. (a-c)].

**Registration with the NMLS**

Every CRMLA-licensed lender engaged in the business of making, servicing, or making and servicing residential mortgage loans and every CRML-licensed mortgage loan originator must shall register with and maintain a valid unique identifier issued by the Nationwide Mortgage Licensing System and Registry. [CA Fin.Code §50002.5 (d) and 10 CCR §1950.122.5 (a)].
When is a California Residential Mortgage Lending License Required?

The CRMLA requires that any person engaged in the business of making or servicing residential mortgage loans obtain a CRMLA license. In general, any form of organization may get a license. This includes natural persons, sole proprietorships, corporations, partnerships, limited liability companies, associations, trusts, joint ventures, unincorporated organizations, joint stock companies, governments, political subdivisions of governments, and any other entity. [CA Fin.Code §50002 (a)].

The CRML License requires that the company has a funding source or is in the process of obtaining a funding source to fund their loans. The CRML License is for companies that plan to fund mortgage loans, not just broker them. Therefore, companies must be financially able to fund mortgage loans with their own money, or have a warehouse line of credit to fund the mortgage loans.

Exemptions to the Residential Mortgage Lending Act

Several entities, largely because they are already regulated by other laws and government agencies, are exempt from CRMLA licensing requirements. [CA Fin.Code §50002 (c)].

Entities Exempt from CRMLA Licensing Requirements

- Banks, trust companies, insurance companies, and industrial loan companies
- Federally chartered savings and loan associations, federal savings banks, and federal credit unions
- Savings and loan associations, savings banks, and credit unions authorized to conduct business in California
- Persons engaged solely in business, commercial, or agricultural mortgage lending
- Wholly owned service corporations of savings and loan associations or savings banks
- Federal, state and municipal governments
- Pension plans making residential mortgage loans to their participants
- Persons acting in a fiduciary capacity conferred by the authority of a court
- Licensed California real estate brokers
- California finance lenders licensed under the California Finance Lenders Law
- Trustees in a foreclosure proceeding. [CA Fin.Code §50002]

Generally, a loan processor or underwriter, if certain other conditions are met, is exempt from obtaining a license. [CA Fin.Code §50003.6]

Based on the exemptions previously listed, a person or entity who is licensed under the CA BRE as a real estate broker or who has a CFL license does not have to obtain a CRML license to conduct residential mortgage activities.

## Applying for a CRML License and Authorizing a Branch Office

### Applying for the CRML License

There is no testing or examination required to obtain a residential mortgage lender or servicer license. The only examination or educational requirements are for employees who engage in lending and/or brokering activities on behalf of the CRMLA licensee. Those employees must be licensed mortgage loan originators (MLOs).

The California Department of Business Oversight lists the eligibility requirements to obtain a CRML license. [10 CCR §1950.122.4].

### Eligibility Requirements to Obtain a CRML License under the CRMLA

1. **Agency Lender/Servicer.** A CRML lender must have a Federal Agency Approval with Fair Housing Administration (FHA), Veterans Administration (VA), Farmers Home Administration (FmHa), Ginnie Mae, Fannie Mae, or Freddie Mac. FHA, Fannie Mae, and Freddie Mac all require companies to have $1 million in net worth to obtain lender approval from them. However, the Veterans Authority (VA) does not have a minimum net worth requirement for its lender approval. Approval as an FHA loan correspondent does not meet this requirement. [CA Fin.Code §50003 (m) & (q)]

2. **Net Worth.** The applicant must provide audited financial statements demonstrating a minimum tangible net worth of at least $250,000. The financial statements must be prepared by a Certified Public Accountant (CPA) in accordance with Generally Accepted Accounting Principles. [10 CCR §1950.122.4 ((a)(4)).

3. **Surety Bond.** The applicant must have a surety bond in the amount of $50,000. The bond must be issued by a company authorized to conduct business in California. [10 CCR §1950.122.4 ((a)(7)].
In addition to the basic eligibility requirements listed above, the NMLS Company New Application Checklist lists other required items. The application has a list of “disclosure questions” and provides a place for the applicant to explain any “Yes” responses and upload a copy of any relevant orders or supporting documents.

NMLS Application Checklist for New Companies Licensed under the CRMLA

**Other Trade Name**: DBA’s should be listed under Other Trade Names on the NMLS Company Form. If the company will be operating under a name other than its legal name, such as a “dba” or **fictitious business name**, the applicant must provide a file-stamped copy of the Certificate of Filing from the County Clerk in California where the fictitious business name was filed. In California, a company is not authorized to use a fictitious business name if an assumed/forced name is issued by the California Secretary of State.

**Qualifying Individual**: The Qualifying Individual is a person in charge and responsible for the actions of the licensee. The supervisor must inspect each business office of the licensee to ensure that the written procedures are enforced. The company must designate a person to supervise and periodically review the activities of the branch managers. If the licensee does not have any branch offices, the supervisor directly supervises and reviews the activities of the mortgage loan originators. The supervisor must be identified on the company application form as a Qualifying Individual.

**Disclosure Questions**: The application has a list of “disclosure questions” and provides a place for the applicant to explain any ‘Yes’ responses. If there are any ‘Yes’ responses, the applicant must include a copy of any relevant orders or supporting documents with the application.

**Audited Financial Statements**: The applicant must provide audited financial statements as of the company’s most recent fiscal year end, or a more recent date. The financial statements must be prepared by a Certified Public Account (CPA) according to Generally Accepted Accounting Principles. The audited financial statements must show a minimum net worth of $250,000.

**Business Plan**: The Business Plan must describe the business to be conducted under the license.
Certificate of Authority/Good Standing Certificate. An applicant that is a corporation, LLC, limited partnership, or trust must submit a Certificate of Authority/Good Standing Certificate from the California Secretary of State showing that the applicant is authorized to transact business in the state of California.

Fidelity Bond. The applicant must provide a copy of a current fidelity bond.

Formation Documents. If the company is a partnership (any type), the applicant must provide a certified copy of the Partnership Agreement.

Management Chart. An organizational chart showing the applicant’s divisions, officers, and managers is required.

Organizational Chart/Description. An organizational chart is required if the applicant is owned by another entity or entities or person, or has subsidiaries or affiliated business entities.

Surety Bond. At a minimum, a $50,000 surety bond shall be furnished by a surety company authorized to conduct business in California.

Fingerprint Cards. Each person filing a NMLS Individual Form must submit fingerprint cards in order to complete a background check.

Customer Authorization for Disclosure of Financial Records. By signing and submitting this form, the applicant gives the DBO the authorization to look at his or her financial records. The authorization cannot be revoked and stays in effect for five years after the expiration (or revocation) of the CFL license.

Federal Agency Approval. The applicant must provide proof that one or more federal agencies have approved the applicant to engage in business as a lender/servicer of federally related mortgage loans.

Designated E-mail. An applicant must establish an e-mail account that is dedicated to receiving e-mail from the DBO Commissioner and that account must be monitored daily.

The applicant must pay the application fee of $900, an investigation fee of $100 and fingerprint processing costs of $62 per person investigated. (The NMLS site, to which the DBO site is linked, states that the total licensing cost is $1,100 including the NMLS processing fee. The application and all supporting documents must be submitted through the NMLS. [10 CCR §1950.122.4 (a-d)].)
Authorizing Branch Office(s)

Each branch location conducting business under a CRMLA license must be separately authorized through the Nationwide Mortgage Licensing System (NMLS). All branch locations in California must be authorized. [10 CCR §1950.122.4 – 1950.122.4.1].

A branch office is any physical location of the entity, other than the “home/main” office location, which is either located in California or if located outside of California conducts activities subject to the California Residential Mortgage Lending Act.

However, businesses located outside of California that do not conduct California business under the California Residential Mortgage Lending Act do not need to be approved.

For each branch location, the licensee must submit an application through the NMLS at least 10 days prior to engaging in business at the new location and submit the NMLS set up fee of $20. The application for approval of a branch office is much shorter and less complex than the application for a license.

Requirements After CRML Licensure

Supervision of Residential Mortgage Loan Originators

Every CRML-licensed residential mortgage lender, mortgage servicer, or residential mortgage lender and servicer (CRML-licensed entity) must supervise the mortgage loan origination, lending and servicing activities of every mortgage loan originator (MLO) that it sponsors.

Every MLO employed by a CRML-licensed entity is subject to the supervision of a branch manager designated by his or her sponsoring CRML-licensed entity.

Every CRML-licensed entity that sponsors MLOs must establish, maintain, and enforce written procedures. A copy of the written procedures must be kept in each business office.

Every CRML-licensed entity must designate a Supervisor who has the following responsibilities:

1. Supervise and periodically review the activities of the branch managers.
2. Periodically inspect each business office to ensure that the written procedures are enforced.
3. In the event a CRML-licensed entity does not have any branch offices, the supervisor directly supervises and reviews the activities of the mortgage loan originators.
The supervisor is identified on Form MU1 as a qualifying individual. A **qualifying individual** is a person in charge and responsible for the actions of the mortgage lender, mortgage broker, and mortgage lender and broker. [10 CCR § 1950.122.6 (a-e)].

**Reporting Requirements**

The following reports must be submitted by all CRMLA licensees by the due date noted.

**Mortgage Banker Annual Report**

Licensees must submit a Report of Principal Amount of Loans Originated and Aggregate Amount of Loans Serviced for the 12-Month Period Ended December 31. This is also called the Mortgage Banker Annual Report. Failure to file timely can result in penalties and/or license suspension or revocation.

Due date: April 4.

**Non-Traditional, Adjustable Rate and Mortgage Loan Survey**

As deemed necessary by the DBO Commissioner can require licensees to submit reports the extent and nature of the non-traditional mortgage loan products being offered. The DBO Commissioner is also authorized to seek and accept information provided on a voluntary basis by residential mortgage loan servicers not subject to the DBO Commissioner’s jurisdiction. CRMLA licensees who offer non-traditional, and adjustable rate mortgage products are regulated in that same manner, using the same language, but a different regulation, as CFL licensees. [10 CCR §1950.314.8]

California Finance Lenders Law licensees are also required to submit this report.

Due date: March 1.

**Residential Mortgage Loan Report**

The vast majority of CRMLA licensees are not required to submit a Residential Mortgage Loan Report because they are required to submit similar reports to various federal agencies.

Due date: March 31.

**Mortgage Call Report**

A Mortgage Call Report (MCR) report is submitted on a quarterly basis. [10 CCR §1950.307].
The Standard MCR contains two components:

1. Residential Mortgage Loan Activity (RMLA) - This component collects application, closed loan, individual MLO, Line of Credit and repurchase information by state.

2. Financial Condition (FC) – This component collects financial information at the company level.

A licensee who is a Fannie Mae or Freddie Mac Seller/Service or a Ginnie Mae Issuer must submit an expanded MCR. (NMLS Mortgage Call Report.)

Due date: 45 days after the end of each quarter.

**Audited Financial Statements**

Licensees must annually submit, through the NMLS, audited financial statements. The statements must, among other things show that the licensee maintains a net worth of at least $250,000. [CA Fin.Code §§ 50200 and 50201.]

Due date: Within 105 days of end of fiscal year.

**Annual Assessment**

On or before September 30 of each year, the DBO levies an annual assessment to be paid by each licensee for the pro rata share of all costs and expenses reasonably incurred in the administration of the CRMLA. The pro rata share is the proportion which a licensee's lending, brokering and servicing activity, as reported on the annual report for the previous calendar year, bears to the aggregate activity of all licensees. The minimum amount $1,000 with a maximum of $5,000. Payment of the annual assessment is required within 20 days of the invoice date. [CA Fin.Code §50401.]

**Surety Bond Requirements**

CRMLA licensees who make and/or service residential mortgage loans are required to maintain a surety bond that covers the activities of the MLOs they employ. The bond amount is based on the amount of origination and/or servicing activities conducted by the licensee in the preceding calendar year, as follows:

<table>
<thead>
<tr>
<th>Aggregate Loans</th>
<th>Bond Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - $50,000,000</td>
<td>$ 50,000</td>
</tr>
<tr>
<td>$50,000,001 - $500,000,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Over $500,000,001</td>
<td>$200,000</td>
</tr>
</tbody>
</table>
Regulatory Examination (Audit)

At least once every four years the DBO Commissioner must examine the affairs of each residential mortgage lender and servicer licensee for compliance with the CRMLA. This is generally called a regulatory examination. In addition, each licensee is subject to a regulatory examination by the Department at any time even if no business has been conducted. The licensee is responsible for the actual cost, including travel expenses, of the regulatory examination. [CA Fin.Code §50302.]

Prohibited Acts and DBO Commissioner’s Authority

Prohibited Acts in General

A short list of prohibited acts in general is found in CA Fin.Code §50503, which provides that it is a violation for any person subject to the act to do any of the following:

- Knowingly or recklessly disbursing funds, except as permitted by CA Fin.Code §50202, or knowingly or recklessly to direct, or in any participate in any activity that constitutes theft or fraud in connection with any trust fund transaction.

Trust funds can be removed and used only for the following:

- Payments authorized by the borrower, allowed by the mortgage loan contract, or required by federal or state law.
- Refunds to the borrower.
- Transfer to another institution that is described in this subdivision.
- Forwarding to the appropriate servicer in case of a transfer of servicing.
- Any other purpose authorized by the residential mortgage loan contract.
- Compliance with a regulatory or court order.

- Knowingly or recklessly make any misstatement or omission of a material fact, pertaining to a loan or loan servicing. (Making untrue statements is also addressed below.)

- Knowingly misappropriate money. This provision is described in more detail below in “Restitution”.

Violation of Federal Laws

Any person who violates any provision of any of the following federal acts or regulations violates the CRMLA. [CA Fin.Code §50505]


**Making False Statements**

Making false statements is prohibited and addressed by the CRMLA in a variety of contexts and statutes.

No person may make any untrue statement of a material fact in any document filed with the DBO Commissioner, or to omit any material fact that is required in any document. [CA Fin.Code §50502]

Similarly, it is unlawful for any person to knowingly make an untrue statement to the DBO Commissioner during the course of licensing, investigation, or examination, with the intent to impede, obstruct, or influence the administration or enforcement of any provision of this division. [CA Fin.Code §50512(b)]

Making any false entry in a company’s books or records, any written report, exhibit, or statement of its affairs or pecuniary condition is prohibited. Anyone having custody of a company’s books must make the books available to the DBO Commissioner for inspection. [CA Fin.Code §50507]

Anyone subject to the act who makes a false entry in any book or record with intent to deceive has committed a violation. [CA Fin.Code §50508]

Similarly, it is unlawful for any person to knowingly alter, destroy, mutilate, conceal, cover up, falsify, or make a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the administration or enforcement of any provision of act. [CA Fin.Code §50512(a)]

**Advertising**

Advertising is not as heavily regulated under the CRMLA as it is under the CFLL. Persons subject to the CRMLA are subject to advertising restrictions found in other applicable laws, for example, laws that are administered and enforced by the California Bureau of Real Estate. However, there are two important CRMLA regulations.

- Blind advertising is prohibited. “Blind” advertising is an advertisement used to solicit business that gives only a telephone number, post office or newspaper box number, or name other than that of the licensee. [10 CCR §1950.204.4.]
Persons subject to the act cannot advertise that it/they are “bonded”, “supervised by”, “regulated by”, “audited by” or “examined by” the State of California or any agency thereof. A reference to licensure can only use the following statement: “Licensed by the Department of Business Oversight under the California Residential Mortgage Lending Act.” [10 CCR §1950.204.3.]

**Disciplinary Authority of the DBO Commissioner**

The DBO Commissioner has broad authority and power to enforce the CRMLA, depending on the violation and circumstances. A general list of the DBO Commissioner’s disciplinary authority is found in CA Fin.Code §50513.

**DBO Commissioner’s Disciplinary Authority**

- Deny, suspend, revoke, condition, or decline to renew a mortgage loan originator license.
- Order restitution
- Impose fines
- Issue desist and refrain orders
- Enter immediate temporary orders to Desist and Refrain Order or direct any other affirmative action as the DBO Commissioner deems necessary.
- Impose a civil penalty not to exceed $25,000
- Order restitution against a mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator for a violation.

**Suspend or Bar Employment**

The DBO Commissioner may suspend, for a period not to exceed 12 months, or bar a person from any position of employment with a licensee if the DBO Commissioner finds that the person has willfully used or claimed without authority a designation or certification of special education, practice, or skill that the person has not attained, or willfully held out to the public a confusingly similar designation or certification for the purpose of misleading the public regarding his or her qualifications or experience. [CA Fin.Code §50511]

**Citations**

The DBO Commissioner has the authority to issue a citation to correct a violation or violations. The DBO Commissioner has the additional authority to issue an order to desist and refrain from violating the act, or issue an order to suspend all business operations.
If a licensee or other person has violated the CRMLA or its regulations, the DBO Commissioner can issue a citation to that person describing the basis of the citation. The citation can include an order to correct the violation or violations that have been identified. In addition, an administrative fine, not to exceed $2,500. The citation and fine are in lieu of any other administrative discipline and they cannot be reported as disciplinary action taken by the DBO Commissioner. [CA Fin.Code §50501.5(a).]

The DBO Commissioner can take more severe action by issuing an order to desist and refrain from violating the act, or issue an order to suspend all business operations. If either of these orders is issued, they are separate from, and in addition to, all other administrative, civil, or criminal remedies. [CA Fin.Code §50501.5(b).]

In either event, the person cited can request a hearing. If a hearing is not requested within 30 days from receipt of the citation, the citation is deemed final. [CA Fin.Code §50501.5(c).]

**Restitution**

If a licensee willfully receives any charges or interest in excess of the amount allowed the DBO Commissioner, in addition to any other penalties or remedies, may order the licensee to return the excess amount to the borrower with interest at the rate of 10%. [CA Fin.Code §50504]

Any one subject to the act who abstracts or misappropriates money, funds, trust obligations, or property deposited with a licensee, commits a violation of the act. If a violation results in a criminal conviction, the court must, in addition to any other punishment imposed, order the person to make full restitution. [CA Fin.Code §50503.]

Anyone subject to the act who misapplies money belonging to a licensee has committed a violation. If the violation results in a criminal conviction, the court must, in addition to any other punishment imposed, order the person to make full restitution to the licensee. [CA Fin.Code §50509]

**Civil Penalties**

A civil penalty cannot exceed $2,500. A civil penalty must be assessed and recovered through a civil action brought by the DBO Commissioner. A civil penalty can be imposed in addition to any other sanctions within the DBO Commissioner’s authority. [CA Fin.Code §50501]

**Initiate Criminal Proceedings**

The DBO Commissioner, through the attorney general or a district attorney can cause a criminal action to be brought against a licensee, but the DBO Commissioner does not have the authority to impose any criminal sanctions or punishments.
Any person who willfully violates the CRMLA or regulations is subject to criminal prosecution. Upon conviction a fine of not more than $10,000 can be imposed and imprisonment in county jail for not more than one year. No person may be imprisoned for the violation of any rule or order unless he or she had knowledge of the rule or order. Criminal liability is in addition to any sanctions that can be imposed by the DBO Commissioner. [CA Fin.Code §50500]

The CRMLA does not authorize a criminal prosecution for a violation of a civil statute. In addition, there are limits on imposing a civil penalty or fine if the licensee can show that it has paid a civil monetary penalty or fine for the same act or transaction, as a violation of other specified laws. [CA Fin.Code §50510]

The California Finance Lenders Law

The California Finance Lenders Law [CFLL] was enacted on July 1, 1995. [CA Fin.Code §22000-22780.] The law is applicable to secured and unsecured, consumer and commercial loans. [CA Fin.Code §§22009 and 22001(b)&(c)].

Stated Purpose of the California Finance Lenders Law

- To ensure an adequate supply of credit to borrowers in this state.
- To simplify, clarify, and modernize the law governing loans made by finance lenders.
- To foster competition among finance lenders.
- To protect borrowers against unfair practices by some lenders, having due regard for the interests of legitimate and scrupulous lenders.
- To permit and encourage the development of fair and economically sound lending practices.
- To encourage and foster a sound economic climate in this state. [CA Fin.Code §22001]

The law is administered and enforced by the California Department of Business Oversight (DBO) under the direction of the Commissioner of Business Oversight. Regulations are promulgated by the Department’s Commissioner. [CA Fin.Code §22005.] Finance lenders and brokers—by number of licensees and dollars of loans originated—are the largest groups of financial service providers regulated by the Department. The law requires any finance lender or broker to obtain a license. [CA Fin.Code §22100.]

A finance lender is defined as “any person who is engaged in the business of making consumer loans or making commercial loans.” [CA Fin.Code §22009.]
A finance broker is defined as “any person who is engaged in the business of negotiating or performing any act as broker in connection with loans made by a finance lender.” [CA Fin.Code §22004.]

A finance lenders license provides the licensee with an exemption from the usury provision of the California Constitution. [CA Fin.Code §22002] In general, absent the exemption, the maximum interest allowed on a loan is the higher of 10% or the Federal Reserve discount rate plus five percentage points. [CA. Const. Art XIV, §1]

For the most part, the law consolidates and replaces the Personal Property Brokers Law, the Consumer Finance Lenders Law, and the Commercial Finance Lenders Law, which were previously applicable to personal property brokers, consumer finance lenders, and commercial finance lenders, respectively.

Several entities that are already regulated by government agencies are exempt from the CFLL. Also, several "non-loan" transactions, such as bona fide leases, automobile sales finance contracts (Rees-Levering Motor Vehicle Sales and Finance Act) and retail installment sales (Unruh Act) are exempt from the CFLL. Exemptions are discussed later in greater detail.

The requirements for a license are set forth in the CA Fin.Code §22100 et seq. The law requires applicants to have and maintain a minimum net worth of at least $25,000 and to obtain and maintain a $25,000 surety bond. In general, principals of the company may not have a criminal history or a history of non-compliance with regulatory requirements. These requirements are described in more detail later.

**When is a California Finance Lenders License Required?**

A California Finance Lenders license can be issued as a finance lender, a broker or both finance lender and broker. Any person or company that engages in the business of making consumer or commercial loans, or any person or company that engages in the business of negotiating or performing any act as a broker in connection with loans made by a finance lender is required to obtain a California Finance Lenders license (CFL license). A finance broker licensed under the California Finance Lenders Law may only broker loans to lenders licensed as finance lenders. The license does not provide the broker with the authority to broker loans to and collect brokerage commissions from other types of lenders such as credit unions and banks. [CA Fin.Code §21000.]
Only companies making or brokering residential mortgage loans are required to be licensed through the NMLS. Non-residential and commercial lenders and brokers must apply directly to the Department of Corporations.

**Exemptions to the California Finance Lenders Law**

The California Finance Lenders Law contains a number of exemptions for persons and entities licensed and regulated by other government agencies. For example, the law does not apply to a loan made or arranged by a licensed residential mortgage lender or servicer. [CA Fin.Code §22060] Similarly, any loan that is made or arranged by a licensed real estate broker and secured by a lien on real property is exempt. [CA Fin.Code §22057.]

In addition, under CA Fin.Code §§22050-22065, several entities and transactions are exempt from the California Finance Lenders Law

**Entities and Transactions Exempt from the CFLL**

- Banks, trust companies, savings and loan associations, insurance premium finance agencies, credit unions, small business investment companies, community advantage lenders, California business and industrial development corporations, or licensed pawnbrokers.

- A check casher who holds an appropriate permit but the exemption does not apply to transactions covered by the California Deferred Transaction Law. [CA Fin.Code §23000 et seq.]

- A college or university making student loans.

- A broker-dealer.

- Any person who makes 5 or fewer commercial loans in a 12-month period, and the loans are incidental to the business of the person relying upon the exemption.

- Any public corporation or other public entity, or agency when making a loan, so long as the public corporation, public entity, or agency complies with all applicable federal and state laws and regulations.

- Any nonprofit cooperative association for agricultural purposes.

- Any corporation, association, syndicate, joint stock company, or partnership engaged exclusively in the business of marketing agricultural, horticultural, viticultural, dairy, livestock, poultry, or bee products on a cooperative nonprofit basis that loans or advances money to its members or in connection with those businesses.
• Any corporation securing money or credit from any federal intermediate credit bank organized “Agricultural Credits Act of 1923” that loans or advances money or credit so secured.

• A California Small Business Financial Development Corporation created pursuant to Corporations Code §14000 et seq.

• Credit cards issued pursuant to a plan whereby the organization issuing the cards can acquire those obligations that its members in good standing incur with those persons with whom the organization has entered into written agreements setting forth the plan, and where the obligations are incurred pursuant to those agreements; or whereby the organization issuing the cards can extend credit to its members. Additional conditions apply to this exemption.

• A bona fide conditional contract of sale involving personal property.

• Premium financing as defined in CA Fin.Code 18563.

• The California Infrastructure and Economic Development Bank.

• A licensed cemetery broker.

• A license to act as a broker under this division does not authorize the licensee to negotiate or perform any act as a broker in connection with loans made or to be made by a lender not licensed as a finance lender under this division.

• Any nonprofit church extension fund (provided certain requirements are met).

• A commercial bridge loan made by a venture capital company to an operating company (provided certain requirements are met).

• A franchise loan made by a franchisor to a franchisee or a sub franchisor or by a sub franchisor to a franchisee.

• A program-related investment, a loan, guaranty, or investment made by a public charity, tax-exempt organization (provided certain requirements are met).

**Exempt Company Registration**

Persons exempt from the CFLL may apply to the DBO Commissioner for an exempt company registration in order to sponsor one or more individuals required to be licensed as mortgage loan originators pursuant to the federal Secure and Fair Enforcement for Mortgaging Licensing Act (SAFE).
A mortgage loan originator who is an insurance producer eligible for a CFL license must originate mortgage loans solely on behalf of the exempt person/company. [CA Fin.Code §22065]

**A mortgage loan originator who is an insurance producer eligible for licensure must meet all of the following requirements:**

- Be covered under an exclusive written contract with, and originate mortgage loans solely on behalf of, that exempt person.
- Hold a current insurance producer license.
- Have a current notice of appointment under Article 9 [commencing with Section 1702] of Chapter 5 of Part 2 of Division 1 of the Insurance Code from an insurer that controls, is controlled by, or is under common control with that exempt person.

A licensed mortgage loan originator who is an insurance producer for an insurer authorized to do business in California may originate loans on behalf of a person registered under CFLL, or of a licensed finance lender that originates loans exclusively for a single person that is engaged in premium financing and exempt from CFLL licensing. [See exemptions previously discussed.]

**Case Study:**

Desist and Refrain Order Issued against Anthony Wayne Brown and The Brown Group of California, LLC.

**The Case:**

Anthony Wayne Brown was the CEO of The Brown Group of California (The Brown Group), a California Limited Liability Company (LLC), located in San Francisco, California.

**Point 1.** Beginning on or before January 2008, The Brown Group and Anthony W. Brown engaged in the business of a finance broker when they agreed to serve as the placement agent in connection with the acquisition of loan financing. The Brown Group and Anthony W. Brown charged their client borrowers advanced fees for the placement of these loans. The funding promised was never received, and the advanced fees were never returned.

Neither The Brown Group nor Anthony W. Brown was licensed by the Commissioner to engage in the business of a finance lender or broker as required by California Financial Code section 22100.

**Point 2.** Beginning on or about December 2008, The Brown Group and Anthony W. Brown engaged in the business of making or servicing residential mortgage loans when they agreed to provide financing through their private investment sources for the acquisition of real property.
Neither The Brown Group nor Anthony W. Brown was licensed by the Commissioner to engage in the business of making or servicing residential mortgage loans as required by California Financial Code section 50002.

Legal Conclusions:

On **Point 1**, the Commissioner issued a Desist and Refrain Order on January 26, 2011. California Financial Code section 22100 prohibits an individual from engaging in the business of a finance lender or broker without a license. California Financial Code section 22712 authorizes the Commissioner to issue a Desist and Refrain Order to any individual who violates California Financial Code section 22100.

On **Point 2**, the Commissioner issued a Desist and Refrain Order on January 26, 2011. California Financial Code section 50002, subdivision (a), prohibits an individual from engaging in the business of making or servicing residential mortgage loans without a license. California Financial Code section 50230 authorizes the Commissioner to issue a Desist and Refrain Order to any individual who violates California Financial Code section 50002, subdivision (a).

**Applying for a CFL License and Authorizing a Branch Office**

There is no requirement regarding education or testing to obtain a California Lenders law license. The basic requirements depend on whether the applicant intends to engage in residential lending or brokerage, or non-residential lending or brokerage.

**Applying for a Residential Lending or Brokerage CFL License**

The California Department of Business Oversight lists the eligibility requirements to obtain a CFL license for residential lending or brokerage.

**Eligibility Requirements to Obtain a CFL License under the CFLL**

- **Net Worth.** A Broker must have and maintain a $50,000 net worth and a Lender/Broker must have and maintain a $250,000 net worth. [CA Fin.Code §22104].

- **Surety Bond.** The applicant must obtain and maintain a minimum $25,000 surety bond. The exact amount depends on the amount of origination activities conducted by the licensee. [CA Fin.Code §22112].

- **No Criminal History or Sanctions.** The applicant must have a history absent any criminal history or history of sanctions by any regulatory agency resulting from dishonesty, fraud, or deceit.
• **Finance Lender Business Plan.** The applicant must have a plan of business consistent with the business of finance lender.

### The Application Checklist for Residential Lending or Brokerage

An application for a license under the California Finance Lenders Law for people engaging in residential lending or brokering must be filed through the Nationwide Mortgage Licensing System (NMLS). [10 CCR §1422].

In addition to the basic eligibility requirements listed above, the NMLS Company New Application Checklist lists other required items.

#### NMLS Application Checklist for New Companies Licensed under CFLL

**Other Trade Name:** DBA’s should be listed under Other Trade Names on the NMLS Company Form. If the company will be operating under a name other than its legal name, such as a “dba” or **fictitious business name**, the applicant must provide a file-stamped copy of the Certificate of Filing from the County Clerk in California where the fictitious business name was filed.

In California, a company is not authorized to use a fictitious business name if an assumed/forced name is issued by the California Secretary of State.

**Qualifying Individual:** An on-site manager must be appointed for all locations where the licensee conducts business with consumers. This person may be called the Branch Manager, must be listed as the “Qualifying Individual” on NMLS Company Form, and his or her business address must match the address listed as the “Main Address” on the Company Form.

**Disclosure Questions:** The application has a list of “disclosure questions” and provides a place for the applicant to explain any ‘Yes’ responses. If there are any ‘Yes’ responses, the applicant must include a copy of any relevant orders or supporting documents with the application.

**Unaudited Financial Statements.** The applicant must provide a current unaudited financial statement prepared according to ‘Generally Accepted Accounting Principles’ that is dated within 90 days of the date of the application. The financial statement must show a minimum net worth of $250,000 for a lender and $50,000 for a broker.

**Business Plan.** The Business Plan must describe the business to be conducted under the license.
Certificate of Authority/Good Standing Certificate. An applicant that is a corporation, LLC, limited partnership, or trust must submit a Certificate of Authority/Good Standing Certificate from the California Secretary of State showing that the applicant is authorized to transact business in the state of California.

Formation Documents. If the company is a partnership (any type), the applicant must provide a certified copy of the Partnership Agreement.

Management Chart. An organizational chart showing the applicant’s divisions, officers, and managers is required.

Organizational Chart/Description. An organizational chart is required if the applicant is owned by another entity or entities or person, or has subsidiaries or affiliated business entities.

Surety Bond. The amount of the surety bond for mortgage lenders, mortgage brokers, or mortgage lender and brokers is based on the total dollar amount of residential mortgage loans they originated in the preceding year. The bond amount varies from $25,000 to $200,000.

If a mortgage lender, mortgage broker, or mortgage lender/broker applicant has no prior year operating history, the applicant must make a good faith estimate of the total amount of loans that may be originated in the upcoming year. This estimate is used to determine the amount of the surety bond.

Fingerprint Cards. Each person filing a NMLS Individual Form must submit fingerprint cards in order to complete a background check.

Customer Authorization for Disclosure of Financial Records. By signing and submitting this form, the applicant gives the DBO the authorization to look at his or her financial records. The authorization cannot be revoked and stays in effect for five years after the expiration (or revocation) of the CFL license.

Applying for a Non-Residential Lending or Brokerage License

The requirements for non-residential brokerage are very similar to the residential requirements except a broker must have and maintain a minimum net worth of $25,000, compared to $50,000 for residential lending, or $250,000 for residential lender/brokerage.
A paper application for a license under the California Finance Lenders Law for companies engaging in lending or brokering that is secured by other than residential real property (non-residential lending and brokerage) must be submitted to the Los Angeles office of the Department of Business Oversight.

**The Application Checklist Non-Residential Lending or Brokerage**

The application checklist is the same for non-residential lending or brokerage, and residential lending or brokerage.

**Authorization of a Branch Office**

A license is required for all branch locations, other than the main office identified on the CFL license, that conduct business with California consumers. [CA Fin.Code §22102].

A *branch office* is any physical location of the entity, other than the “home/main” office location, which is either located in California or if located outside of California conducts activities subject to the California Finance Lenders Law.

Non-residential and commercial lenders and brokers are required to be licensed under the California Finance Lenders Law, but they must apply directly to the Department of Business Oversight.

However, all branches of companies engaged in making or brokering loans secured by residential real property are required to obtain a license through the NMLS.

The **Nationwide Mortgage Licensing System (NMLS)** is the official system for companies and individuals seeking to apply for, amend, renew, and surrender license authorities managed through NMLS by state agencies. The NMLS itself does not grant or deny license authority.

Before the company can file a MU3 form (branch office), the company must have a MU1. The NMLS Branch New Application Checklist includes several items.

**Form MU1** is the uniform licensing form developed by the NMLS for a mortgage lender, mortgage servicer, or mortgage broker business, entitled “Uniform Mortgage Lender/Mortgage Broker Form.” [10 CCR §1950.003 (d) and 10 CCR §1404(g)].

**Form MU3** is the uniform licensing form developed by the NMLS for the branch office of a mortgage lender, mortgage servicer, or mortgage broker, entitled “Uniform Mortgage Branch Office Form.” [10 CCR §1950.003 (f) and 10 CCR §1404(i)].
Branch New Application Checklist for CFL License

**Branch Manager:** A branch manager must be designated for each licensed location. **Branch manager** is defined as an individual whose principal office is physically located in, who is in charge of, and who is responsible for the business operations of a branch office. A branch cannot be left in charge of someone who is not familiar with the CFL laws and regulations. Each branch manager must complete a NMLS Individual Form in connection with the filing of a branch application.

**Disclosure Questions:** The application has a list of “disclosure questions” and provides a place for the applicant to explain any ‘Yes’ responses. If there are any ‘Yes’ responses, the applicant must include a copy of any relevant orders or supporting documents with the application.

**Branch Written Agreement:** A copy of the agreement between the licensee and the branch manager must be submitted with the application.

**Fingerprint Cards.** The branch manager filing a NMLS Individual Form must submit fingerprint cards in order to complete a criminal background check.

Requirements After CFL Licensure

After obtaining a license, a licensee must maintain the net worth and surety bond requirements described in the licensing section and comply with the DBO Commissioner’s rules and regulations.

**Place of Business, Display of Licenses, and Change of Address**

A finance lender, broker, or mortgage loan originator licensee can only have one place of business under a license. [CA Fin.Code §22152. A finance lender, broker, or mortgage loan originator licensee can only transact business under the name and at the place of business named in the license. There are two exceptions. First, if the borrower requests that a loan be initiated or made at another location. Second, if the licensee uses a webpage for solicitation, initiation, and making loans. [CA Fin.Code §22155.]

A finance lender license, broker license, and the license of every employed mortgage loans originator must be conspicuously displayed at the authorized place of business. A license is not transferable or assignable. [CA Fin.Code §22151.]
A licensee must notify the Department of a change of address at least ten days prior to the move. The DBO Commissioner has 10 days to notify the licensee if the change is disapproved, otherwise it is deemed approved. Failure to notify the DBO Commissioner can result in a penalty not to exceed $500. [CA Fin.Code §22153.]

**Supervision of Mortgage Loan Originators**

Every CFL-licensed mortgage lender, mortgage broker, and mortgage lender and broker (CFL-licensed entity) must supervise the mortgage loan origination, lending and servicing activities of every mortgage loan originator (MLO) that it sponsors.

Every MLO employed by a CFL-licensed entity is subject to the supervision of a branch manager designated by his or her sponsoring CFL-licensed entity.

Every CFL-licensed entity that sponsors MLOs must establish, maintain, and enforce written procedures. A copy of the written procedures must be kept in each business office.

Every CFL-licensed entity must designate a Supervisor who has the following responsibilities:

1. Supervise and periodically review the activities of the branch managers.

2. Periodically inspect each business office to ensure that the written procedures are enforced.

3. In the event a CFL-licensed entity does not have any branch offices, the supervisor directly supervises and reviews the activities of the mortgage loan originators.

The supervisor is identified on Form MU1 as a qualifying individual. A **qualifying individual** is a person in charge and responsible for the actions of the mortgage lender, mortgage broker, and mortgage lender and broker. [10 CCR §1414 (a-e)].

**Record Keeping**

A licensee must keep books, accounts, and records that will enable the DBO Commissioner to determine if the licensee is complying with the CFLL. The records must be preserved for at least 3 years after making the final entry on any loan record. Any information requested by the DBO Commissioner must be provided within 48 business hours. Original records are not required. [CA Fin.Code §§22156 and 22157.]
Annual Report

Each licensee is required to file an annual report by March 15th of each year, even if no business has been conducted. Failure to file the report can result in a summary revocation of the license. [CA Fin.Code §§22159, 22159.5, 22715] A separate addendum must be filed with the report regarding non-traditional and adjustable rate mortgage products.

Additional Reports

The DBO Commissioner may also require licensees to provide additional reports concerning their residential mortgage loan servicing activities. Mortgage loan servicing activity means receiving more than 3 installment payments of principal, interest, or other amounts placed in escrow, pursuant to the terms of a mortgage loan, and performing services relating to that receipt or the enforcement of its receipt, on behalf of the holder of the note evidencing that loan. The relevant regulation cites as an example, reports in connection with the Mortgage Servicers Survey, first published by the Department of Corporations in December 2007. The DBO Commissioner is also authorized to seek and accept information provided on a voluntary basis by residential mortgage loan servicers not subject to the DBO Commissioner’s jurisdiction. [CA Fin.Code §22159.5.]

Annual Assessment

On or before September 30th of each year, the Department notifies each licensee of the amount assessed and levied against it and that amount must be paid by October 31st. The minimum assessment is $250 per licensed location. Failure to pay the assessment can result in loss of the license. [CA Fin.Code §22107.]

Surety Bond Requirements

Each licensee is required to maintain a surety bond in a minimum amount of $25,000 at all times. The DBO Commissioner may require a higher bond amount for a licensee who employs one or more mortgage loan originators and who makes or arranges residential mortgage loans, based on the dollar amount of residential mortgage loans originated by that licensee and any mortgage loan originators employed by that licensee. Every mortgage loan originator employed by the licensee must be covered by the surety bond. [CA Fin.Code §22112.]

The minimum surety bond amount for a licensee who does not originate residential mortgage loans is $25,000. The surety bond amounts for a licensee who is engaged in residential mortgage loans is based on the aggregate dollar amount of residential mortgage loans originated by the licensee in the preceding calendar year, as follows:
### Aggregate Dollar Amount Bond Amount

- 0 - $1,000,000  $25,000
- $1,000,001 - $50,000,000  $50,000
- $50,000,001 - $500,000,000  $100,000
- Over $500,000,001  $200,000

### Net Worth Requirements

Each licensee must maintain a net worth of at least $25,000 at all times. A licensed finance broker that employs one or more mortgage loan originators and that arranges, but does not make, residential mortgage loans must maintain a minimum net worth of at least $50,000. A licensed finance lender and broker that employs one or more mortgage loan originators and that makes residential mortgage loans must maintain a minimum net worth of at least $250,000. [CA Fin.Code §22104.] These amounts are also displayed in the table below:

<table>
<thead>
<tr>
<th>Licensee Activity</th>
<th>Net Worth Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>All licensees</td>
<td>$25,000</td>
</tr>
<tr>
<td>Broker/employs MLO/does not make residential loans</td>
<td>$50,000</td>
</tr>
<tr>
<td>Lender and broker make residential loans</td>
<td>$250,000</td>
</tr>
</tbody>
</table>

### Regulatory Examination [Audit]

Each licensee is subject to a regulatory examination by the Department at any time even if no business has been conducted. “Examination”, in this context means a review of the licensee’s books and records, much like an audit. The licensee must pay the actual cost of the regulatory examination. Failure to pay the cost of examination may subject the licensee to administrative action including the revocation of the license. [CA Fin.Code §§22701, 22707, 22714.]

### Non-Traditional, and Adjustable Rate Mortgage and Mortgage Loan Products

Non-traditional and adjustable rate mortgage products are subject to regulation that is more extensive. [10 CCR §1436]. For non-traditional and Adjustable Rate Mortgage products, best practices must be implemented to manage risk on a continuous basis.

Two major reports on best practices, referred to collectively as “Guidance” are identified, and incorporated by reference into the regulations, and must be followed for non-traditional, and adjustable rate mortgages.
A separate written document must be included with the licensee’s annual report explaining how it has implemented best practices for non-traditional and adjustable rate mortgage. The separate report must also include the number of consumer complaints received, the consumer complaint resolution process, and the status of unresolved complaints.

Additional disclosures are also required including a disclosure that allows the borrower to compare a non-traditional or adjustable rate mortgage with a typical loan. The regulation offers two ways to meet that disclosure obligation.

**DBO Commissioner’s Authority, Prohibited Acts, and Regulation of Consumer Loans**

**Authority of the DBO Commissioner**

The DBO Commissioner may make general rules and regulations and specific rulings, demands, and findings to enforce the California Finance Lenders Law, in addition to, and within the general purposes of, the law. [CA Fin.Code §22150.] This is the kind of broad authority often given to regulators.

Depending on the offense involved, the DBO Commissioner can impose a variety of civil penalties and invoke various remedies. [CA Fin.Code §22172.]

**Civil Penalties and Remedies**

- Deny, suspend, revoke, condition or refuse to renew a license
- Order restitution
- Issue orders to desist and refrain
- Enter a temporary order to cease business
- Order or direct any other affirmative action the DBO Commissioner deems necessary
- Impose fines not to exceed $25,000 for each violation

**Suspension or Bar From Employment**

The DBO Commissioner may suspend (not to exceed 12 months) or bar a person from any position of employment with a licensee, if the DBO Commissioner finds that the person willfully used or claimed a designation or certification of special education, practice, or skill that the person has not attained. [CA Fin.Code §22168.]

Suspension, not to exceed 12 months, or a bar from employment can also be ordered if the DBO Commissioner finds either of the following:
bullet That the censure, suspension, or bar is in the public interest and that the person has committed or caused a violation of this division or rule or order of the DBO Commissioner, which violation was either known or should have been known by the person committing or causing it or has caused material damage to the finance lender, broker, or mortgage loan originator, or to the public.

bullet That the person has been convicted of or pleaded nolo contendere to any crime, or has been held liable in any civil action by final judgment, or any administrative judgment by any public agency, if that crime or civil or administrative judgment involved any offense involving dishonesty, fraud, or deceit, or any other offense reasonably related to the qualifications, functions, or duties of a person engaged in the business in accordance with the provisions of this division. [CA Fin.Code §22169.]

In addition, the DBO Commissioner may bring a civil action, or have the Attorney General bring a civil action. Remedies include, but are not limited to, injunctive relief, restitution, or damages. Willful violations can include a civil penalty not to exceed $2,500 for each violation. [CA Fin.Code §22713.]

Finally, the DBO Commissioner, through the Attorney General or a district attorney can have criminal proceedings filed. Conviction can result in a fine not to exceed $10,000 or imprisonment in county jail not to exceed one year, or both. [CA Fin.Code §§22753 & 22780.]

### Prohibited Acts in General

The CFLL provides a general list of acts that are prohibited. Pursuant to CA Fin.Code §22161(a-f), no person subject to the act shall:

bullet Make a material false or misleading statement about the terms and conditions of a loan.

bullet Advertise, print, display, publish, distribute, or broadcast any statement with regard to the rates, terms, or conditions for making or negotiating loans, that is false, misleading, or deceptive, or that omits material information.

bullet Commit any act that would take unconscionable of a homeowner whose property is in foreclosure. [ ]

bullet Violate California’s Unfair Competition Law. [B&P §17200 et seq.]

bullet Knowingly misrepresent, circumvent, or conceal, through subterfuge or device, any material aspect or information regarding a transaction to which the person is a party.

bullet Commit an act that constitutes fraud or dishonest dealings.
In addition, the following regulations are applicable:

- A licensee cannot require a borrower to waive any statutory or regulatory provisions of the California Finance Lenders Law. [10 CCR §1408.]

- A finance lender shall immediately report, in writing, to the DBO Commissioner any criminal action filed against such company or its directors, officers or management personnel. [10 CCR §1411.]

- Every employee of a finance company who negotiates for or makes any loan pursuant to the Law shall familiarize oneself with the laws, rules, and regulations governing such loan business. No office shall be left in charge of any person who is not informed concerning such laws, rules, and regulations. [10 CCR §1446.]

**CFLL Advertising Rules**

The DBO Commissioner requires that licensees who advertize their services in writing or orally (radio, television, online, blog, etc.) in California must disclose the type of license under which the loan would be made or arranged. [CA Fin.Code §22162.]. In any advertisement, a finance company can only refer to its licensure with the following statement, “Loans made or arranged pursuant to a California Finance Lenders Law license.” In addition, every advertisement must include the licensee’s unique identifier. [10 CCR 1550.] Additionally, the CFLL tightly controls and monitors advertising.

**CFLL Advertising Rules**

- The DBO Commissioner may require a licensee to submit advertising copy for review prior to its use. The DBO Commissioner also can disapprove advertising already in use. [CA Fin.Code §22165.]

- The DBO Commissioner may require licensees to maintain a file of all advertising copy for 2 years from the date of its use. The file must be available to the DBO Commissioner upon request. [CA Fin.Code §22166.]

- A licensee must not advertise, in any way, a statement or representation that is false, misleading or deceptive. [CA Fin.Code §22161[b].]

- Blind ads are prohibited. **Blind advertising** is an advertisement used to solicit business that gives only a telephone number, post office or newspaper box number, or name other than that of the licensee. [10 CCR 1557.]
If any advertisement refers to interest rates, charges, or cost of loans, those items must be stated fully and clearly, and in a manner that the DBO Commissioner deems necessary to give adequate information to prospective borrowers. [CA Fin.Code §22164.]

Pursuant to 10 CCR §1436 the following are deemed false, misleading, or deceptive. [CA Fin.Code §22161(b)]. Any advertisement of an installment in repayment of an adjustable rate, interest only or payment-option loan without an equally prominent disclosure of the following information about the loan as applicable:

- Principal amount
- Term of loan
- Initial interest rate
- Number of months the initial interest rate will be in effect
- Fully-indexed interest rate
- Maximum interest rate
- If different, an explanation of the difference between the payment rate, initial interest rate and fully-indexed rate
- Annual percentage rate
- How often the interest rate and payments can change
- Maximum periodic change in the interest rate and payments [periodic caps]
- Number of months and percentage of original loan amount after which minimum payments will not be accepted and the loan re-amortizes
- The monthly payment based on the maximum interest rate, and the loan balance after all negative amortization is included, assuming minimum payments are made
- If the loan contains a prepayment penalty, a statement to that effect
- If the loan contains a balloon payment, a statement to that effect

**Violating Federal Acts/Regulations also Violates CFLL**

A licensee, who violates any provision of certain federal consumer protection acts with respect to consumer loans, also violates the California Finance Lenders Law. [CA Fin.Code §22346]
Federal Consumer Protection Laws

- Real Estate Settlement Procedures Act (RESPA), as amended [12 U.S.C. Sec. 2601 et seq.].
- Truth in Lending Act (TILA), as amended [15 U.S.C. Sec. 1601 et seq.].
- Home Ownership Equity Protection Act (HOEPA) [15 U.S.C. Sec. 1639].

Rules Regarding Consumer Loans

A consumer loan is a loan that is unsecured or secured by either real or personal property. The proceeds of the loan are intended for personal, family, or household purposes. [CA Fin.Code §22203].

Collateral Agreements

A borrower cannot be required to buy anything else or enter into any collateral sales agreement as a condition of a loan. Certain types of insurance, for example title insurance and credit insurance are not considered collateral sales contracts. [CA Fin.Code §§22311-22315, 22321.]

Reasonable Fees for Loans Secured by Real Property

Reasonable fees may be charged for appraisals, use of an automated valuation model, escrow fees, and late fees. [CA Fin.Code §§22317-22318, 22320.5.]

Loans Made Outside the State of California

Loans made outside the state are generally enforceable in the state. [CA Fin.Code §§22322-22324.]

Loans Secured by a Lien on a Motor Vehicle

Loans secured, in whole or in part, by a motor vehicle are subject to strict requirements regarding notices that must be given to consumers. In addition, the notices required and distribution of proceeds after default and sale of the vehicle are specified. [CA Fin.Code §§22328-22329.5.]

Sale of Loans to Institutional Investors

Subject to certain restrictions, a licensee may sell a loan to an institutional investor. [CA Fin.Code §22340.]

Instant Loan Check or Live Check

So-called “instant loan checks” or “live checks” are subject to strict advertising and disclosure requirements. [CA Fin.Code §22342.]
Summary

The two agencies in California that license individuals and business entities to originate residential mortgage loans are the California Bureau of Real Estate (CalBRE) and the California Department of Business Oversight (DBO).

The California Department of Business Oversight (DBO) offers two different types of mortgage company licenses, the California Residential Mortgage Lender License (CRML License) and the California Finance Lender License (CFL License).

The California Residential Mortgage Lending Act, as its name implies is limited in scope to residential mortgage lending. A key qualification for a license is that an applicant must be an approved lender or service for specified federal agencies. The DBO Commissioner of Business Oversight is given broad authority to administer and enforce the act.

The California Finance Lenders Law is intended to protect borrowers and foster a sound economic climate in California. Exemptions to the act are primarily for businesses already regulated through other laws and by other government agencies. Extensive procedures are in place to ensure that only qualified applicants obtain a license. Licensees must adhere to a comprehensive set of laws and regulations.