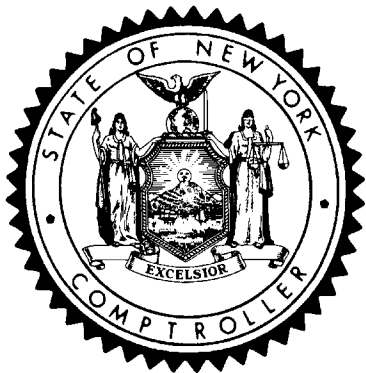


***State of New York  
Office of the State Comptroller  
Division of Management Audit  
and State Financial Services***

**NEW YORK STATE BANKING  
DEPARTMENT**

**REGULATION OF THE MORTGAGE  
BANKING INDUSTRY**

**REPORT 97-S-66**



***H. Carl McCall***

*Comptroller*



# State of New York Office of the State Comptroller

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## Division of Management Audit and State Financial Services

### Report 97-S-66

Ms. Elizabeth McCaul  
Acting Superintendent  
New York State Banking Department  
2 Rector Street  
New York, NY 10006

Dear Ms. McCaul:

The following is our audit report on the Banking Department's regulation of the mortgage banking industry.

We conducted this audit according to the State Comptroller's authority as set forth in Article V, Section 1, of the State Constitution, and Article II, Section 8 of the State Finance Law. We list major contributors to this report in Appendix A.

*Office of the State Comptroller  
Division of Management Audit  
and State Financial Services*

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# Executive Summary

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## New York State Banking Department Regulation of the Mortgage Banking Industry

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### Scope of Audit

Mortgage bankers (bankers) specialize in making loans to finance the purchase of, or equity in, one- to four-family residential properties. Due to a rapidly-expanding consumer market, they have been placing increasing reliance on mortgage brokers (brokers) to initiate loans to consumers. During calendar year 1997 alone, mortgage bankers provided 141,337 mortgage loans, totaling \$16.5 billion, to State residents. The New York State Banking Department's (Department) Mortgage Banking Division (Division) is responsible for the investigation, licensing, and registration of mortgage bankers and brokers; and the performance of periodic on-site examinations of their continuing business activities. Division staff also handle consumers' mortgage-related complaints. During fiscal 1996-97, the Division collected more than \$2.4 million in licensing and registration fees, \$99,147 in fines, and recovered \$127,904 in refunds for consumers.

Our audit addressed the following questions regarding the effectiveness of the Division's regulation of the mortgage banking industry for the period January 1, 1996 through May 31, 1998:

- Are mortgage banker and broker applicants screened adequately to prevent the licensing or registration of unqualified persons, and are license and registration fee revenues accounted for properly?
- Are periodic on-site examinations of mortgage bankers and brokers performed in compliance with Department guidelines and schedules?
- Are Division examiners doing an effective job of following up on consumer complaints?

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### Audit Observations and Conclusions

We found that, in general, Division examiners are doing an effective job in regulating the mortgage banking industry. However, we have identified several opportunities for improvement that would enhance the Department's regulatory effectiveness.

Banker and broker applicants are required to describe and affirm, in writing, their prior business activities, financial responsibilities, educational background, experience, and their general character and fitness. Banker applicants are also required to procure a background check performed by a private investigations firm licensed by New York State. We found that

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Division examiners perform thorough reviews of the applicants. However, we noted that banker applicants are asked to hire their own investigative agency to perform the required background checks. Thus, these reviews may not be truly independent. We recommend that the Department consider directly hiring the investigations firms to perform background examinations of mortgage banker applicants. (See pp. 5-6)

We identified eight brokers who were required to be registered, but were not. Their businesses were not being regulated, and any improper practices they may have been engaged in would be undetected by Division staff. Although the Department does not have regulatory authority over brokers who are operating without being registered, it does refer such unregistered brokers to the State Attorney General's Office (AG) for further action. However, they are unaware of what actions, if any, the AG takes, since the AG has not been responding to the Department's inquiries. We recommend that the Department continue its efforts to communicate with the AG and if no effective action is being taken, consider seeking legislative authority to fine or otherwise penalize offenders. (See pp. 6-7)

Licensed bankers and registered brokers are not required to pass a qualifying exam or attend continuing education courses. Our review of a sample of Division examination files found that, in responding to examiner findings, most of the bankers and brokers implied that they were unfamiliar with State regulations. Thus, despite current licensing and registration requirements, it does not appear that all brokers and bankers are fully aware of the governing statutes. We recommend that the Department study the benefits of instituting a qualifying examination for applicants and/or continuing education requirements for licensed bankers and registered brokers, similar to those instituted by other states. (See pp. 7-9)

We also reviewed a sample of mortgage-related complaints and determined that the appropriate bankers and brokers were promptly notified, and before each case was closed, examiners requested and received relevant information necessary to formulate a conclusion. Where appropriate, immediate corrective action was taken. However, we note that certain types of complaints (e.g., "excessive" broker fees) that are of valid concern to the consumer are outside the jurisdiction of the Division. We believe Department officials should enhance their outreach efforts to inform mortgage banking consumers about the Division's restricted scope of authority, as well as the consumer's individual responsibility to seek out the lowest rates available from reputable bankers and brokers. (See pp. 15-17)

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## **Comments of Department Officials**

In general, Department officials believe their use of available resources is appropriate and there is no need to implement most of our recommenda-

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tions. Department officials did indicate, however, that they will include more consumer-related, mortgage-banking issues in their outreach programs.

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<b>Appendix A</b>	Major Contributors to This Report
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# Introduction

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## Background

Mortgage bankers (bankers) specialize in making loans to finance the purchase of, or equity in, one- to four-family residential properties. According to New York State (State) Banking Department (Department) statistics, mortgage bankers operating in the State are enjoying a rapidly-expanding consumer market. Thus, they have been placing increasing reliance on intermediaries, such as mortgage brokers (brokers), to initiate loans to consumers. During calendar year 1997 alone, mortgage bankers provided 141,337 mortgage loans, totaling \$16.5 billion, to State residents.

Brokers, who may represent several bankers concurrently, sell their services on the basis of securing the best-available deal for those seeking financing. Because banker and broker activities have a significant fiscal impact on homeowners, their communities, and the State's housing industry in general, the State Legislature noted in its enabling legislation that "it is essential for the protection of the citizens and the stability of the State's economy, that reasonable standards governing the business practices of mortgage bankers and their agents be imposed."

The Department's Mortgage Banking Division (Division) is responsible for providing this protection and regulation. Its principal goals are to ensure that the mortgage banking industry operates fairly, honestly, and efficiently, and refrains from deceptive and anticompetitive practices; and that consumers seeking a residential mortgage are protected adequately from unscrupulous and unethical business practices.

The major regulatory tools employed by the Division are the investigation, licensing, and registration of mortgage bankers and brokers; and the performance of periodic on-site examinations of their continuing business activities. Division staff also follow up on consumers' mortgage-related complaints; review and assess mortgage advertisements for compliance with Article 12-D of the New York State Banking Law (Law) and the Superintendent's own regulations; and initiate enforcement actions against noncompliant bankers and brokers.

The Division, which has 36 employees, including a deputy superintendent and 29 examiners, expended \$1.7 million on personal service costs for fiscal year 1996-97. During this same period, it collected more than \$2.4 million in licensing and registration fees and \$99,147 in fines; and recovered \$127,904 in refunds for consumers.

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## **Audit Scope, Objectives, and Methodology**

We audited the effectiveness of the Division's regulation of the mortgage banking industry for the period of January 1, 1996 through May 31, 1998. Our objectives were to determine whether mortgage banker and broker applicants are screened adequately to prevent the licensing and registration of unqualified persons; whether license and registration fee revenues are accounted for properly; whether on-site examinations are performed in compliance with Department guidelines and schedules; and whether Division examiners do an effective job of following up on consumer complaints. To accomplish our objectives, we reviewed and analyzed applicable policies, procedures, laws and regulations; and interviewed relevant Department officials and staff, representatives from the Office of the Attorney General, and selected bankers and brokers. We also reviewed a sample of Department files relevant to applicant licensing, on-site examinations, and the resolution of consumer complaints and inquiries. Lastly, we performed revenue-accountability tests for licensing fees received during the audit period, and reviewed advertisements to identify unlicensed bankers and unregistered brokers.

We conducted our audit according to generally accepted government auditing standards. Such standards require that we plan and perform our audit to assess adequately those operations of the Department that are included in our audit scope. Further, these standards require that we understand the Department's internal control structure and its compliance with those laws, rules and regulations that govern the operations in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing management's estimates, judgments, and decisions. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to audit. This approach focuses our audit efforts on those operations identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use our finite audit resources to identify where and how to make improvements. Thus, we devote little audit effort to reviewing operations that may be efficient or effective. As a result, we prepare our audit reports on an "exception basis." This report, therefore, highlights those areas needing improvement and does not focus on activities that may be functioning properly.



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## **Internal Control and Compliance Summary**

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Our consideration of the Department's internal control structure over its license and registration fee revenue, found that it is adequate to capture and accurately record relevant revenue transactions.

## **Response of Department Officials**

A draft copy of this report was provided to Department officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Superintendent of the Banking Department shall report to the Governor, the State Comptroller, and leaders of the Legislature and its fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

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## Licensing and Registration

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As part of its regulatory responsibilities, the Division is responsible for licensing bankers and registering brokers who seek to operate in the State. The Law requires bankers and brokers to be licensed and/or registered so that the State can regulate their activities and help to ensure competence and integrity in the industry. More specifically, Section 590 of the Law stipulates that any person, partnership, association, corporation, or other entity must obtain a mortgage banking license before making five or more mortgage loans in the State during any calendar year; and must be registered as a mortgage broker before soliciting, processing, placing or negotiating a mortgage loan, or offering to solicit, process, place, or negotiate such a loan in the State. Certain organizations such as insurance companies, as well as banks organized under the laws of other states, are exempt from this requirement.

During calendar years 1996 and 1997, approximately 250 bankers and 1,700 brokers were licensed or registered to operate in the State. Twenty-eight of these bankers, and 145 of the brokers, were newly licensed/registered in calendar year 1997.

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### Application Process

Notarized applications for banker licenses and broker registrations must be submitted in writing, in a form prescribed by the Superintendent of Banking. All applicants are required to describe and affirm their prior business activities, financial responsibilities, educational background, experience, and their general character and fitness. In addition, mortgage banker applicants are required to procure and submit the results of a background check performed by a private investigations firm licensed by New York State.

We selected a judgmental sample of 20 application files, representing 10 bankers and 10 brokers, that had been processed during the audit period. We sought to determine whether the applicants had submitted all required information; and whether Division examiners had reviewed and analyzed the submitted information before the licenses and registration certificates were approved. We found that Division examiners had performed thorough reviews of the sampled applications. In addition, applications are reviewed and approved by Department supervisors before licenses and registration certificates are issued.

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However, we noted that banker applicants are asked to hire their own investigative agency to perform the required background checks. Thus, these reviews may not be truly independent, since the individuals whose backgrounds the investigators are reviewing are also their clients. In fact, we did not identify any negative investigation reports in our sample. It is possible that, to ensure customer satisfaction, the investigative services firms are hesitant to disclose information that could be damaging to their clients.

When we discussed this issue with Division officials, they told us they believe that the current investigation process is sufficient for their purposes, and that they have been satisfied with the integrity of the investigative services firms hired by the applicants. In response to our draft report, Department officials reaffirmed their position citing the independent checks and balances they incorporate into the application process, such as Division-initiated fingerprint checks, that they believe negate the need for them to change the current process.

Although we acknowledge the efforts made by Department officials to enhance the integrity of the investigation process, and have considered them during our field work, we believe that they do not substitute for a comprehensive, independent third-party investigation. This could be ensured if the Division hired the investigative agencies to perform the required background checks.

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## **Unregistered Brokers**

To determine whether any unregistered brokers are operating in the State, we selected a judgmental sample of 241 firms or individuals who advertise on the Internet and/or in telephone directories under the category of “mortgages.” Through inquiries and reviews of Department records, we found that eight of these 241 brokers were required to be registered but were not. Thus, their businesses were not being regulated, and any improper practices they may have been engaged in would be undetected by Division staff. In addition, in such cases, the State is not receiving its proper share of broker registration revenue because these individuals are not paying the fees they owe for the opportunity to operate in New York.

When we discussed this issue with Division officials, they told us they are aware that unregistered brokers are operating in the State. They said that staffing limitations have forced them to discontinue the practice of actively looking for unregistered brokers. Instead, they said, they usually become aware of unregistered brokers as a result of consumer complaints and

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referrals from consumer-protection agencies and registered brokers. In fact, during the audit period, the Division received 66 complaints against unregistered brokers, some of them repeat offenders.

Since the Department does not have regulatory authority over unregistered brokers, Division representatives send questionnaires to these brokers and solicit information pertaining to their operations. Each questionnaire is accompanied by a letter informing the unregistered broker of the State's broker-registration requirements, and a notice that a complaint was filed with the Division.

Division officials also informed us that the unregistered brokers who fail to respond to their inquiry are referred to the Office of the State Attorney General (AG) for further action. However, Division officials told us that they do not follow up to determine what action has been taken by the AG, because their previous inquiries have gone unanswered. Also, they do not follow up to determine whether the referred unregistered brokers have ceased doing business, since these matters are in the hands of the AG. When we attempted to follow up on these cases, the AG's office was unresponsive to our inquiries. We believe the Department should continue to follow up with the AG and if no effective action is being taken, consider seeking legislative authority to fine or otherwise penalize offenders.

In response to our draft report, Department officials stated that they believe the authority to prosecute unregistered entities is properly placed with the AG. They further stated that they routinely publish the names of unauthorized broker or banker operations in the Department's weekly bulletin, thereby exposing them to the general public.

Considering the continuing identification of unregistered brokers, and the apparent lack of attention afforded this matter by the AG, we believe Department officials are obliged to revisit their position. They should consider a more aggressive posture against these entities to better protect the mortgage banking consumer.

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## **Banker/Broker Qualifications**

Licensed bankers and registered brokers are obligated to operate in compliance with Article 12-D of the Law and all other applicable mortgage banking regulations and statutes. Knowledge of the Law would help them operate fairly and competently, prevent improper business practices from occurring, and promote customer satisfaction.

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Our review of a judgmental sample of 30 Division examination files, representing 10 bankers and 20 brokers, found that examiners often identify noncompliance issues that can, and sometimes do, result in the levying of fines and penalties against bankers and brokers. In fact, examiners found instances of noncompliance for 10 of the bankers and 16 of the brokers in our sample, such as undisclosed broker fees.

In responding to examiner findings, most of these bankers and brokers implied that they were unfamiliar with State regulations. This position was substantiated by the examiner files, which inferred banker/broker unfamiliarity with the Law, not willful noncompliance. Thus, despite current licensing and registration requirements, it does not appear that all brokers and bankers are fully aware of the governing statutes.

Department officials told us that the current Law does not require applicants for banker licenses and broker registrations to pass a qualifying examination or to participate in continuing professional education once they are licensed or registered. Banker applicants are required to have five years of experience in making residential mortgage loans, or similar lending and credit-evaluation experience. Broker applicants, in contrast, are required to have just two years of relevant mortgage brokerage, credit analysis, or underwriting experience. (Licensed real estate brokers and attorneys-at-law in good standing do not need prior mortgage brokerage experience to be registered.) In addition, Department officials said that all approved banker applicants must attend a briefing on the requirements of Article 12-D and other applicable regulations and statutes before they can receive their licenses. Approved broker applicants, who are based in New York City, must attend a similar meeting.

We canvassed representatives of the mortgage industry regulators in 16 other states, and found that 3 of them require banker and broker applicants to pass a qualifying examination. In addition, two of these three states, as well as one of the remaining 13, require licensed bankers and registered brokers to maintain their professional status by attending continuing professional education courses. Division officials also informed us that representatives of New York State's mortgage industry have proposed a bill that would require brokers to present proof of their continuing professional education in order to retain their registration. A version of this bill is currently before the State Legislature.

Division examiners informed us that they support the idea of a written test for new applicants and continuing professional education for licensed bankers and registered brokers like the one currently required for real

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estate brokers. However, Department officials disagreed, indicating that they do not believe that a written test would produce any tangible benefits. Moreover, they said such a test would create financial and logistical issues that would need careful review by the Department. In response to our draft report, Department officials indicated that they are not adverse to the concept of a continuing education program for mortgage bankers and brokers; however, they believe it should be administered by the private sector, which - in their opinion - is better suited to do so. In either event, we believe that it is necessary for the Department as regulator, to spearhead such an initiative.

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## **Licensing and Registration Fees**

Each banker and broker applicant is required to pay an application fee stipulated by statute: \$1,000 for a banker applicant and \$500 for a broker applicant. Applicants who apply after June 30 are required to pay just half of these amounts. In addition, to maintain their licensed or registered status, bankers and brokers must continue to pay the fees each year thereafter. The Department also charges bankers and brokers fees for field examinations, change-of-ownership notices, late payments, and bounced checks. The Department reports collecting more than \$2.4 million in fees during calendar years 1996 and 1997.

We reviewed the Department's controls over the collecting, recording, depositing, and reporting of Division revenues during the 27-month period ending March 31, 1998. Our review included tracing a sample of 50 banker and broker fees to the Department's books of record; and reconciling the fees collected with the number of licensed bankers and registered brokers for several blocks of time during calendar years 1996 and 1997. We found that, in general, fees have been recorded properly and processed in compliance with established Department procedures.

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### **Recommendations**

1. Consider having the Division, rather than the applicant, hire the investigative agencies to perform the required background checks.
2. Enhance lines of communication with the Attorney General's Office regarding the actions taken against unregistered brokers. If no effective action is being taken, consider the benefits of seeking legislative authority that would allow the Department to fine/penalize the offenders.
3. Study the benefits of instituting a qualifying examination for applicants and/or continuing educational requirements for licensed bankers and registered brokers. If it is deemed beneficial, develop a strategy for implementing such examination and/or training.



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## **On-Site Examinations**

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Article 12-D of the Law authorizes the Superintendent of Banks to investigate the business, and examine the books, accounts, records, and files, of every licensed mortgage banker and registered mortgage broker operating in the State. The purpose of such an examination is to obtain a first-hand knowledge of banker/broker business practices, and to review the compliance of each business with statutory and Department requirements. For bankers, the examination includes an assessment of their financial condition and ability to meet their mortgage commitments.

Unlike the statutes governing other categories of banking institutions (e.g., commercial banks and thrifts), Article 12-D does not specify how often mortgage bankers/brokers should be examined. Instead, the examination intervals are determined by Department policy. Until December 1996, the policy was to examine all newly-licensed bankers and newly-registered brokers within one year after they became qualified. Thereafter, bankers were to be examined at least once every two years, and brokers were to be examined at least once every three years. In addition, special field examinations are performed as often as Division managers believe they are warranted.

Effective January 1997, the Department revised its examination policy and now requires all newly-registered brokers to be examined within six months of their initial registration. Thereafter, it will examine brokers again every three years, unless the broker has brokered five or fewer loans and the Department has received no consumer complaints against him or her, in which case the examination will be performed every five years. The examination interval for bankers continues to be every two years.

After conducting each examination, the examiner is to prepare a written report detailing the examination scope and objectives, its findings and conclusions, and, where appropriate, the examiner's recommendations for corrective action. After supervisory review and approval, the reports are to be issued to banker/broker management and other interested Department bureaus.

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### **Compliance with the Examination Schedule**

The Division uses a computerized examination scheduling process to ensure that all brokers and bankers are scheduled for an examination according to policy. To help ensure the timely identification of improper business practices and potential banker solvency concerns, it is imperative

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that Division examiners perform their examinations in compliance with these schedules.

A total of 1,039 mortgage brokers and 228 mortgage bankers were scheduled for examination for calendar years 1996 and 1997. Although the majority of these examinations were performed in compliance with Division policy, we found several that were not. Of the 714 brokers scheduled for examination in calendar year 1996, for example, 96 (13 percent) were not examined until 1997. Four (3 percent) of the 126 mortgage bankers scheduled for examination in 1996 were actually examined in 1997. Similarly, 22 (7 percent) of the 325 mortgage brokers who were supposed to be examined in 1997 were not examined until 1998.

Noncompliance with the Department's examination policy and the Division's examination schedules can perpetuate improper business practices, and delay necessary corrective action. For example, we reviewed several reports issued on bankers and brokers who had not been examined during the originally-scheduled periods. In two of the reports, the examiners identified instances in which brokers had failed to disclose relevant information to the consumer, such as points payable to the lender, and brokers' fees. These findings, which we were informed are common occurrences with brokers, resulted in \$1,755 in Division-initiated refunds to consumers. If these examinations had been performed as originally scheduled, the deficiencies could have been identified and corrected earlier.

Division officials told us that they allocate between five and eight examiner days for each banker examination; in contrast, each broker examination is allocated an average of one day. They said that examiners performing on-site examinations of bankers are required to review 25 files, or 10 percent of all files - whichever is less - for all new applications, closed applications, and loans in process. In addition, examiners are required to review 25, or 5 percent - whichever is less - of the applications that had been rejected or withdrawn. On the other hand, during broker examinations, no minimum number of files must be reviewed. Instead, the number of broker files selected for review depends on how many an examiner can review in the allocated time. In either case, Division representatives told us that additional time can be allocated if the examiner believes a more extensive review is required. However, we found no evidence that additional time had been requested for the examinations performed during our sampled period.

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To determine the number of examiner days available for each year during the review period, we multiplied the number of Division examiners assigned to perform on-site examinations (10 for both 1996 and 1997) by the average number of examiner work days per year (200). This amount excludes weekends, holidays, vacation, sick and personal leave, as well as allocated training days. Using this formula, we calculated that 2,000 examiner days were available for each year. To determine the number of examiner days necessary to meet the Department's examination schedules for this period, we multiplied the number of examinations scheduled for each year by examination category, then multiplied that number by the average number of days we were told it takes to complete each examination (one day for a broker examination and 6.5 days for a banker examination). We determined that 1,533 examiner days were needed for calendar year 1996, while 988 days were needed for 1997. Thus, the available examiner days for these two years exceeded the necessary number by 467 days in 1996 and by 1,012 days in 1997.

We asked Department officials why examinations were not being performed as originally scheduled. They said that, although the annual examination schedule is tied to the calendar year, the examination cycle actually spans from February 15, when most annual license and registration fees are paid up, to February 14 of the following year. They told us that it would be imprudent and costly for them to perform examinations of bankers or brokers who had decided not to pay their fee and allowed their registrations or licenses to lapse. They also noted that the examinations we cited as starting late had been completed within the first quarter of the following calendar year. Furthermore, they explained, since the examination intervals are based on Division policy - which may be subject to periodic revision - rather than a statute, they have not breached their regulatory responsibilities. Further, in response to our draft report, Department officials stated that deviations from their examination schedule are generally infrequent, arise from unforeseen events, and are manageable in the overall context of their supervisory approach.

We acknowledge that the examination schedule is based on Division policy, not a statute. In fact, we applaud Division management for developing a sound comprehensive examination policy. However, we continue to conclude that compliance with the established schedule remains preferable for the prompt identification of potential banker solvency issues or improper broker business practices.

Since it appears that all examinations scheduled during the audit period could have been performed as initially planned, we believe that Department officials need to implement a monitoring system to determine why

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Division staff are not complying with the examination schedule. We also believe they need to develop an action plan to help ensure future compliance. Such compliance would help ensure that improper business practices are identified on a timely basis, and enhance the effectiveness of the Department's overall regulation of the industry.

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## **Assessment of Individual Examinations**

We selected a judgmental sample of 30 examiner files prepared during the audit period, representing 10 bankers and 20 brokers, to determine whether the required examination procedures had actually been performed, and to obtain evidence of supervisory review. We found that, in general, the examinations were thorough, complete, and in compliance with applicable examination procedures. Examiners identified several instances of banker/broker noncompliance with governing statutes and regulations, and recommended prompt corrective action in each case.

### **Recommendations**

4. Make every effort to comply with Department policy when performing on-site examinations of bankers and brokers.
5. Implement a monitoring system that will enable Department officials to determine why the Division is not complying with the annual examination schedules. If it is determined that utilizing a calendar-year schedule is not in the Division's best interest, redesign the annual schedule as warranted.

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## Consumer Complaints

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As part of its statutory mandate to protect the banking consumer, the Division is charged with overseeing the resolution of mortgage-related consumer complaints and inquiries. To fulfill this responsibility, the Division employs four examiners who respond to each complaint and assume the role of consumer advocate. These examiners are required to retrieve sufficient information and documentation from all relevant parties before they reach a conclusion.

During calendar years 1996 and 1997, the Division received 3,171 mortgage-related complaints from consumers. Of these, 166 were deemed to be outside of the Department's statutory authority (e.g., unlicensed operators or home improvement contractors), and the complainants were told to seek relief elsewhere. Of the 3,005 complaints determined to be under the Department's jurisdiction, such as those regarding undisclosed broker fees, 2,955 were resolved and Division examiners were able to secure \$529,095 in refunds to consumers.

To determine whether Division examiners were responding to complaints in a timely manner, we reviewed a judgmental sample of 60 complaints the Division had received during our audit period. Fifteen of the complaints were banker-related, and 45 were broker-related. Each complaint had been logged in and acknowledged immediately upon receipt, after which the appropriate bankers and brokers were promptly notified. Before each sampled case was closed, examiners requested and received relevant information necessary to formulate a conclusion on the complaint. If the complaint addressed banker/broker noncompliance with Article 12-D of the Law, immediate corrective action was taken. In fact, 28 of the sampled case resolutions resulted in consumer refunds totaling \$111,478. Based on our review of the sampled files, we conclude that Division examiners follow up on consumer complaints effectively and efficiently.

However, we note that certain types of complaints that are of valid concern to the consumer, such as "excessive" broker-processing fees, are outside the jurisdiction of the Division. Therefore, their concerns cannot be resolved through the complaint process. For example, one claimant, who had applied for and received a mortgage loan of \$155,000, noted that she had been informed verbally by her broker that his fee for securing her a loan would be between \$8,000 and \$10,000. However, on the actual date of closing, a broker's fee of \$15,500, or 10 percent of the borrowed amount, was deducted from the loan proceeds. Since the claimant had signed an agreement acknowledging that she was informed that a

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10-percent broker's fee would be deducted from the loan proceeds, it was a legally-binding contract over which the Department has no jurisdiction. Our review of the sampled files noted a number of similar complaints.

In another example, an employee of a mortgage banker complained that he was not paid the required commissions he was promised by his employer. He also noted that the employer had accepted approximately 100 loan applications and corresponding fees, but had closed on just three of the applications. A Division examiner referred this complaint to the mortgage banker, who replied that issues related to commissions paid to employees are contractual and therefore outside of the Division's purview. Division representatives closed this file under the category "complaint-disputed."

In yet another case, an elderly consumer informed the Division that senior citizens were being targeted by unscrupulous mortgage brokers. She told Division representatives that she was approached by an individual who asked her if she would like to have an "extra \$30,000 in her pocket." She alleged that the individual told her his company was running a "sale" for senior citizens; and that he had personal information about her, including the fact that she had an existing mortgage on her property. Moreover, he reportedly assured her that she did not need a lawyer, and that he would provide her with door-to-door transportation to the lender's office. She said that she expected to receive at least \$20,000 in cash when she refinanced her former \$105,000 mortgage. However, after closing on the new \$124,000 loan, the lender informed her that there would be no money left for her by the time the existing mortgage and other charges were paid. She asked Division officials to have the new financing arrangements set aside. They were unable to assist her because, according to documents she signed at closing, all of the information and costs relevant to her mortgage loan had been disclosed to her and her representative before she signed the agreement.

Because the Department lacks statutory authority to resolve certain mortgage-related consumer complaints, some complainants have voiced their disappointment with the process and the Department's inability to resolve what they believe to be valid complaints. Department officials told us that they are as aggressive in representing consumers as the Law and other applicable regulations allow them to be. They noted that the Department is not a judiciary agency and does not arbitrate issues of fact or contractual disputes. However, they observed that many brokers and bankers issue refunds to complainants just because the Department is involved. Moreover, they told us that a pattern of complaint activity could be an indication of other underlying banker/broker problems. They

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said Division personnel make an effort to follow up on such patterns at the next scheduled field examination for those institutions. In certain circumstances, a special investigation may be initiated.

To prevent exploitation of the uneducated or uninformed consumer, some states place a “cap,” or maximum limit, on mortgage broker fees. We contacted the banking industry regulators in 22 other states and found that seven of them, including Connecticut, Colorado, and Delaware, have implemented such caps. For example, the State of Connecticut limits broker fees to 8 percent of the amount borrowed, while the State of Colorado limits broker fees to 21 percent. However, the average fee reportedly charged by mortgage brokers in these states ranges between 2 percent and 4 percent of the loan amount applied for.

In response to this assertion, Division officials said that educated consumers operating in a free market environment would force brokers to keep their fees competitive. They also said they are concerned that the existence of a cap could become a broker’s rationale for charging the highest fee allowed under the regulation. Moreover, they said that it was conceivable that some brokers might inform consumers that they must charge the maximum amount. They also told us it would be extremely difficult to define the cap in a manner that is fair to all brokers in all types of situations, based on the different levels of difficulty encountered by a broker in placing different loans, and the varying degrees of effort required to process such.

Finally, Division officials told us that representatives of the Department’s Consumer Services Unit visit various communities to inform them about banking services and about their rights as consumers under the Law. They said these outreach visits do not address mortgage banking issues unless consumers ask specific mortgage-related questions.

We believe Department officials should enhance their outreach efforts to inform mortgage banking consumers about the Division’s restricted scope of authority, as well as the consumer’s individual responsibility to seek out the lowest rates available from reputable bankers and brokers. (In response to our draft report, Department officials indicated that they will take steps to incorporate mortgage-related issues into their outreach agenda.)

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### **Recommendations**

6. Include consumer-related mortgage-banking issues in the Department's consumer outreach program.
7. Study the benefits and feasibility of introducing legislation that would "cap" mortgage broker application/processing fees.



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# Major Contributors to This Report

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November 9, 1998

Mr. Frank J. Houston  
Audit Director  
Office of the State Comptroller  
Division of Management Audit &  
State Financial Services  
270 Broadway, 19<sup>th</sup> Floor  
New York, NY 10007

Dear Mr. Houston:

In accordance with Section 170 of the Executive Law, attached is the Banking Department's response to the draft audit report, 97-S-66 "Regulation of the Mortgage Banking Industry."

Very truly yours,

A handwritten signature in black ink, appearing to read "Gideon Weingarten".

Gideon Weingarten  
Director, Internal Audit

CC: Elizabeth McCaul, Acting Superintendent of Banks  
Daniel A. Muccia, First Deputy Superintendent  
Richard Ehl, Deputy Superintendent  
Kristine Detric, Executive Assistant

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**Response to Draft Audit Report 97-S-66  
"Regulation of the Mortgage Banking Industry"**

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**Recommendation One:** *Consider having the Division, rather than the applicant, hire the investigative agencies to perform the required background checks.*

**Response:** The Department does not believe there is any demonstrated need for adoption of this recommendation. Our current system incorporates several checks and balances to ensure an independent report is rendered. These include requiring that the investigative agency be licensed, the investigator's credentials be subject to independent review, and parallel background investigations by Division staff including fingerprint checking be conducted. We have seldom encountered discrepancies in the private investigator's reports of sufficient magnitude to discredit the findings.

**Recommendation Two:** *Enhance lines of Communication with the Attorney General's Office regarding the actions taken against unregistered brokers. If no effective action is being taken, consider the benefits of seeking legislative authority that would allow the Department to fine/penalize the offenders.*

**Response:** The Banking Department is a non-adjudicative body. We can best carry out our legislative mandate by concentrating our resources on the entities we regulate rather than on those that we do not license. The authority to prosecute unlicensed entities is in our judgment properly placed in the Attorney General's Office. Furthermore, we routinely use the Department's Weekly Bulletin to alert the public and the industry whenever we encounter an unauthorized mortgage broker or banker operation that claims to be registered or licensed by this Department.

**Recommendation Three:** *Study the benefits of instituting a qualifying examination for applicants and/or continuing educational requirements for licensed bankers and registered brokers. If it is deemed beneficial, develop a strategy for implementing such examination and or training.*

**Response:** The Banking Department is not adverse to the concept of continuing educational requirements for bankers and/or brokers, however, we do not think the best solution is a government-imposed education and testing program. The Department believes the burden of providing the resources and the expertise to administer such requirements is more appropriately placed on the private sector, which is better positioned to efficiently and effectively conduct this training.

**Recommendation Four:** *Make every effort to comply with Department policy when performing on-site examinations of bankers and brokers.*

**Response:** The Mortgage Banking Division makes every effort to comply with the Examination Schedule. However, when deviations do occur they are generally infrequent, arise from unforeseen events or those that cannot be planned for, and are manageable in the overall context of our multifaceted supervisory approach.

**Recommendation Five:** *Implement a monitoring system that will enable Department officials to determine why the Division is not complying with the annual examination schedules. If it is determined that utilizing a calendar-year schedule is not in the Division's best interest, redesign the annual schedule as warranted.*

**Response:** See the response to Recommendation Four.

**Recommendation Six:** *Include consumer-related mortgage-banking issues in the Department's consumer outreach program.*

**Response:** We agree and will coordinate with our Consumer Services Division to include more information about these issues in outreach programs where the audience is appropriate. In addition, the Department's Internet Website has abundant information for the consumer as well.

**Recommendation Seven:** *Study the benefits and feasibility of introducing legislation that would "cap" mortgage broker application/processing fees.*

**Response:** The Department believes fees are best regulated by providing consumers with a competitive marketplace with clearly disclosed fee structures. The relatively high fees allowed in the few states that have enacted caps illustrate the ineffective results of Government mandated fees. Informed consumers making informed decisions is the best defense against price gouging. The Division's program consisting of legally mandated pre-application fee disclosures, on-site examinations, aggressive consumer complaint follow-up, and consumer education coupled with outreach programs is designed to provide consumers with the information they need to make informed credit decisions.

