The SAFE Ac Unlevel Playing

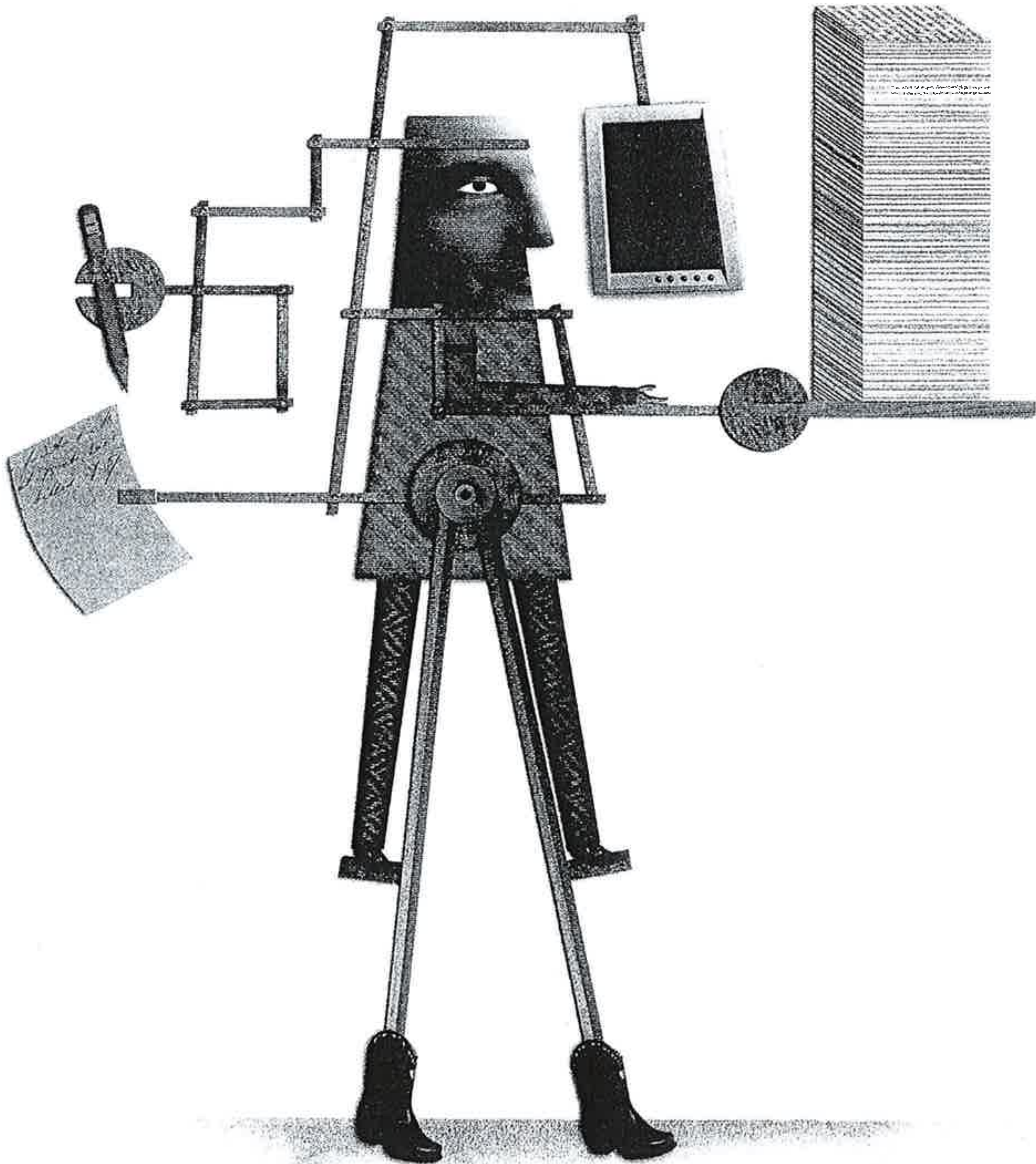

ILLUSTRATION BY JOYCE HESSELBERTH

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Non-depository mortgage lenders face much steeper compliance costs under the SAFE Act's licensing provisions.

BY JOHN P. KROMER AND HEIDI M. BAUER

In the nearly two years since Congress passed the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (commonly known as SAFE), the one known truth may be this: Blessed are those who hold a bank charter. SAFE requires national licensing and registration of individual mortgage loan originators, and was intended to bring greater uniformity of regulation of loan officer employees of banks, mortgage lenders and mortgage brokers by bringing all loan originators on to a common regulatory platform. But two years on, non-depository mortgage companies are finding achievement of this goal is not only elusive but unlikely, given that implementation of SAFE is resulting in substantially unequal regulation among industry members. Making matters worse is the Department of Housing and Urban Development's (HUD's) proposed SAFE Act rulemaking, which further expands the scope of SAFE (and its applicability to mortgage banking personnel) for non-depository mortgage companies, compared with their depository counterparts.

Calculating the price tag for non-depository lenders

While one of the stated goals in the preamble to SAFE is to "increase uniformity" in the residential mortgage industry, there is a vast difference in the compliance burden—and its associated price tag—between depository and non-depository lenders. SAFE requires states to enact systems for licensing and registering "loan originators" and encourages them to participate in the Web-based Nationwide Mortgage Licensing System and Registry (NMLS&R).

An individual loan originator employed by a depository institution, a depository institution subsidiary that is federally supervised or an institution regulated by the Farm Credit Administration can be registered under a system regulated and supervised by the federal banking agencies. Conversely, loan originators who work for non-depository mortgage companies must become fully licensed in each state where they originate loans and must satisfy a host of burdensome pre-licensure and post-licensure requirements.

Pre-SAFE, fewer than half of the states required individual loan originators to be licensed. Therefore, the mere fact that post-SAFE, some kind of state license or federal registration is required represents a significant increase in the regulatory demands on the mortgage industry. Moreover, the new application requirements and online application process, with its multiple steps and stages, while modernizing the process, is a significant departure from the previous paper-copy application days.

Registration versus licensing

The differing requirements for registration versus licensing are stark. Under SAFE, registrants must fulfill only four requirements, while licensees must fulfill, variously, as many as nine. As summarized in Figure 1,

the additional five requirements include 20 hours of pre-license education, passing a national test, and eight hours of annual continuing education. And because SAFE's requirements merely establish a floor, about half the states have imposed additional state-specific pre-license and/or continuing-education requirements. Loan originator registrants, on the other hand, are not required to complete a single hour of education or take any test.

The burden increases exponentially for licensees who intend to do business on a multi-state basis. Once registered, a loan originator employee of a bank can originate loans throughout the country. A licensed loan originator employed by a non-bank mortgage company must obtain separate licenses from each state.

Various efforts have been made to put a price tag on the anticipated SAFE compliance costs for non-depository lenders. Rough calculations suggest it will cost a non-depository about $1,000 per state to license one individual loan originator. With a prudently designed and efficient licensing plan, the average fee could possibly be reduced to about $500 per state per loan originator.

As depicted in Figure 2, these estimates include the following hard costs associated with securing licenses:

Figure 1 Loan Originator Federal Registration v. State Licensure Requirements

Federal Registration Requirements:	State Licensure Requirements:
1. Maintain registration through NMLS&R.	1. Maintain licensure through NMLS&R.
2. Provide fingerprints for an FBI national and state (as applicable) criminal history background check.	2. Provide fingerprints for an FBI national and state (as applicable) criminal history background check.
3. Provide authorization for NMLS&R to obtain any information related to any administrative, civil or criminal findings by any governmental jurisdiction.	3. Provide authorization for NMLS&R to obtain any information related to any administrative, civil or criminal findings by any governmental jurisdiction.
4. Satisfy behavioral requirements: • Never been convicted of any criminal offense involving dishonesty or a breach of trust or money laundering, or entered into a pre-trial diversion or similar program in connection with a prosecution for such offense, except with prior written consent of certain federal agencies —i.e. Farm Credit Administration (proposed draft rule).	4. Provide authorization for NMLS&R to obtain a credit report.
	5. Satisfy behavioral requirements: • Never had a loan originator license revoked; • No felonies in the past seven years; and • No felonies involving fraud, dishonesty, breach of trust or money laundering.
	6. Obtain a passing score of 75 percent or better on a national test created by NMLS&R.
	7. Take 20 hours of pre-licensure education courses approved by NMLS&R.
	8. Demonstrate financial responsibility and general fitness.
	9. Maintain net worth or surety bond, or pay into a surety bond recovery fund.

SOURCE: BUCKLEYSANDLER LLP

Figure 2 Price Tag Calculation for State Loan Originator Licensure

Licensure Requirement:	Fee or Expected Cost:
Application fee	Ranges from $80–$930
Fingerprint processing/background check fee	$39 (likely to be incurred multiple times)
Pre-licensure education fees for national component	$399
Pre-licensure education fees for select state components	$396
National component examination fee	$92
Select state examination fees	$69
Study guide materials for national component examination	$199
Study guide materials for available state components	$99
Credit report fee	$25 (likely to be incurred multiple times)
Averaged Total =	**Approximately $500 per license**
Estimated cost of licensing *one* loan originator in all jurisdictions = $25,500	
Estimated cost of licensing *100* loan originators in all jurisdictions = $2,550,000	

SOURCE: BUCKLEYSANDLER LLP

1) application fees; 2) NMLS&R processing fees; 3) background report/fingerprint processing fees; 4) credit report fees; and 5) enrollment fees for continuing education, ranging from fees for study guides, reference materials and examination fees to reimbursements for expenses such as travel.

While some economies of scale may be realized by applying for licenses in all 50-plus jurisdictions at once, the compounding state-specific requirements suggest that few individuals will license one time under NMLS&R for nationwide loan origination authority. Thus, non-depositories may pay some of the same fees—such as background report fees and credit report fees—several times a year for one loan originator.

Contrast this with the one-time registration fee and fingerprint processing/background check fee that depositories pay to register an individual nationwide. While the nationwide registration fee is not yet known (the federal agencies have yet to issue final regulations and the NMLS&R is still developing the registration system), it is widely expected that the total cost of registration will be only a fraction of the cost of a single state license. Thus, the cost of licensing a loan originator employed by a non-bank mortgage company in all 50 states may easily be 50 to 100 times the cost of registering a loan originator employed by a bank or other depository institution.

Larger mortgage companies will likely need to hire personnel devoted exclusively to managing licensing of loan originators.

An accurate cost comparison for licensing and registration requires consideration of more than just out-of-pocket expenses, however. The logistics of securing, monitoring and maintaining licenses for employees will tax non-depositories' licensing and compliance staffs, especially for those with many loan originators.

Larger mortgage companies will likely need to hire personnel devoted exclusively to managing licensing of loan originators. If they cannot, other operational, administrative and managerial functions may suffer from the drain on staff resources as staff members are moved to support licensing efforts. Lost productivity must also be factored into the equation, as hours of pre-license and continuing education will take away from time otherwise spent originating loans as licensees likely will face a waiting period before they can begin to take loan applications.

By way of example, a loan originator seeking licenses on a nationwide basis must complete 20 hours of general pre-license education, plus an additional 50 hours of state-specific education. Factoring in a minimum of 10 hours of study time and four hours to sit for the examination, and the loan originator employed by a non-depository will have invested 84 production hours—roughly two work weeks—to become licensed.

In reality, how many top-producing loan originators will be willing to sit on the sidelines, enduring the hassles and expenses of the licensing process, when they can go down the street and work for a bank at significantly less cost, with fewer requirements and with no delays? Will non-bank lenders and brokers be able to attract bank-employed registered loan officers?

Federal banking agencies and HUD—divergent rules on SAFE compliance

While SAFE established a separate system of licensing for some loan originators and registration for those fortunate enough to work for a depository institution, the manner in which the law is being implemented, particularly as interpreted by HUD, threatens to increase the imbalances between federal and state regulation of loan originators and thwart Congress' stated goal of uniform regulation.

HUD is the federal agency designated by SAFE with responsibility for determining whether state laws implementing SAFE meet the requirements of the federal statute. To the extent that a state does not establish a licensing system for loan originators that is consistent with SAFE, HUD has back-up authority to implement a back-up licensing system for loan originators in that state.

On Dec. 15, 2009, HUD issued its eagerly awaited proposed rules, which were not required by SAFE, but which HUD felt compelled to issue. HUD's proposal was met with much criticism and concern, particularly from those in the industry who saw HUD exceeding its authority in issuing a rule and in addressing topics outside its limited role under SAFE as arbiter of conformity of state laws and provider of a back-up licensing system. Examples include HUD's proposed definitions of several terms not defined in the statute, including an "application," what constitutes "offering or negotiating" and "compensation or gain," as well as its proposed expansion of licensing requirements to loss-mitigation specialists working for loan servicers. HUD's rule would apply to licensed loan originators but not registered loan originators, who are subject to the regulations of the federal banking agencies. More than 7,000 public comments were filed on the rule at www.regulations.gov. As of early June, a final rule had not been issued and it was not clear when a rule would be forthcoming from HUD.

In reviewing HUD's proposed rulemaking, comparison with the proposed rules of the federal banking agencies and the draft final rule released by the Federal Deposit Insurance Corporation (FDIC) in late 2009 is inevitable.

On several key points, HUD would expand the scope of SAFE as applied to licensed loan originators, while the banking agencies would pursue a more narrowly tailored interpretation of SAFE and its applicability to depository institution loan originators.

Defining the term 'loan originator'

One of the key differences between SAFE rules of the federal banking agencies and HUD's proposed rules is the way HUD proposes to "clarify" or "interpret" certain phrases, including the term "loan originator." HUD's expansive definition enlarges the circle of potential licensees and licensable activities. In SAFE, a loan originator is defined as "an individual who takes a residential

mortgage loan application; and offers or negotiates terms of a residential mortgage loan for compensation or gain."

In an effort to help states adopt SAFE-compliant laws, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR), both based in Washington, D.C., developed a Model State Law, which HUD determined to be in conformity with the minimum requirements of SAFE. The Model State Law defined loan originator with the disjunctive "or" instead of "and" between the two elements of the definition, thereby requiring licensing for any individual whose job triggers prong one or prong two, but not necessarily both.

By contrast, the federal banking agencies have proposed SAFE rules that retain the conjunctive term "and" used in the statute enacted by Congress. While this may seem to be a legalistic debate over two small words, it has a potentially significant consequence as it means that fewer employees of depository institutions are subject to SAFE requirements than those of non-depository mortgage companies.

In the area of loan modifications, a major public-policy imperative, HUD has suggested through Frequently Asked Questions on its website and its proposed rulemaking that it would be appropriate to regulate this activity under SAFE and require loan-modification specialists to become licensed as loan originators. Leaving aside the fact that all of the education and examination materials developed to date are focused on the origination of loans, not their modification, there is nothing in SAFE that would require this result and it will likely hinder the ability of servicers to help borrowers obtain loan modifications by diverting time and resources toward licensing. Moreover, the federal banking agencies appear likely to conclude, based on the draft final regulation released by the FDIC, that loan-modification activities are not covered by SAFE.

These are only a handful of examples of how HUD's proposed approach to SAFE implementation would foster disunity between depository institutions and non-depository mortgage companies.

HUD's rulemaking authority open to question

Finally, as noted here, there are significant questions outstanding regarding HUD's ability to issue regulations and the scope of its authority under SAFE. SAFE grants HUD three very limited roles: 1) to provide for a default licensing system in any particular state that failed to have its SAFE-compliant law in place by the mandated deadline; 2) to provide for a default licensing and registration system should the NMLS&R fail to do so; and 3) to determine whether a state's law and licensing system meets the minimum standards of SAFE.

Despite these three clearly delineated and narrow roles, HUD proclaims in the preamble to its proposed rule that it is "propos[ing] to clarify or interpret certain statutory provisions that pertain to the scope of the SAFE Act licensing requirements." It is unclear that under SAFE, HUD has this authority.

Several of the comment letters on HUD's proposed SAFE Act rule challenge the agency's authority to issue the rule. With no credible claims that the NMLS&R has failed to fulfill its minimum requirements nor a HUD determination that any state's SAFE-compliant licensing law fails to meet the minimum requirements, some industry and legal commenters are asking why HUD is engaged in expansive rulemaking under SAFE. Others are openly hinting—or blatantly stating—that HUD is exceeding the scope of its authority under SAFE in its proposed rule.

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Even Fannie Mae and Freddie Mac question HUD's authority to re-interpret the definition of the term "loan originator." The agencies' joint comment letter points to evidence that in enacting SAFE, Congress was specifically concerned with preventing further abuse by mortgage loan originators and brokers, as those terms are customarily used and understood within the industry, which would not cover those engaged in mortgage loan servicing.

While HUD had not issued its final regulation as of early June, it will be intriguing to see whether HUD takes to heart the challenges to its authority or whether it is looking for a fight. As we have seen in other contexts, most recently with respect to the Real Estate Settlement Procedures Act (RESPA) reform rule, HUD is not shy about asserting authority in the face of statutory ambiguity and has generally been successful in defending itself in litigation when its authority is challenged. We would expect that this issue will ultimately be resolved by a court—particularly if HUD insists on retaining provisions of its SAFE rule that appear to be outside the scope of its limited authority or that would expand SAFE beyond what is supported by the statute.

Summing up

As state licensing requirements for loan originators take effect, and the status of HUD's rulemaking and the implementation of the registration system for employees of depository institutions and their subsidiaries remain unsettled, many questions persist regarding the implementation of SAFE two years after its enactment.

However, regardless of the outcome of each specific issue, it is clear at this point that a primary goal of SAFE—the formation of a uniform system of regulation for loan originators—is unlikely to be achieved, at least in the near term. Rather than creating a more level playing field, SAFE's separate and distinctly non-uniform requirements will likely increase the growing market advantage of banks in the mortgage industry. **MB**

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