

## GUEST COMMENTARY

### SAFE, OR OUT? WHO'S IN, WHO'S NOT UNDER THE SAFE ACT

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It's been four years since the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 was signed into law. The SAFE Act encouraged states to establish a statutory framework for licensing "loan originators" — that is, individuals who take residential mortgage loan applications *and* offer or negotiate loan terms for compensation or gain. In enacting the SAFE Act, Congress sought to address non-uniform state licensing laws, which were seen as contributing to the mortgage and foreclosure crisis.

Every state complied with the SAFE Act by enacting licensing laws meeting the minimum requirements of the SAFE Act. Additionally, every state transitioned its loan originator licensing platform to the Nationwide Mortgage Licensing System, a web-based system created and maintained by the American Association of Residential Mortgage Regulators and the Conference of State Bank Supervisors.

The U.S. Department of Housing and Urban Development was tasked with administering and enforcing the SAFE Act until the Consumer Financial Protection Bureau took over those responsibilities in July 2011, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. HUD first attempted to clarify the SAFE Act in December 2008 via an interpretive letter. Six months later, HUD answered nine frequently asked questions on the SAFE Act.

In December 2009, HUD published its proposed rule implementing the SAFE Act, receiving in response more than 5,300 comments from consumers, regulators, and industry members. After almost a year and a half reviewing these comments, HUD published its final rule in June

2011. The CFPB effectively adopted this rule as Regulation H, in December 2011. Regulation H clarifies several ambiguities, but questions remain about the term “loan originator.”

We examine here whether persons whose activities do not fit squarely within the definition of “loan originator” — specifically loan modification specialists, loan processors, underwriters, insurance agents, financial advisors, housing counselors, and individual property sellers — are subject to state licensing as loan originators under the SAFE Act and guidance interpreting it, including Regulation H. (*Editor’s Note:* This article does not address *federal registration* of loan originators employed by depository institutions, certain of their subsidiaries, or institutions regulated by the Farm Credit Administration.)

### LOAN MODIFICATION SPECIALISTS

Loan modification activity has surged since the mortgage and foreclosure crisis, bringing with it scrutiny of the individuals involved in modifications. The SAFE Act does not expressly state that employees of loan servicers who conduct modification tasks must be licensed as loan originators. However, because these tasks may include taking residential mortgage loan applications or offering or negotiating loan terms, they arguably fall within the definition of “loan originator.”

In the past, HUD explained that *some* loan modification specialists are subject to licensing, emphasizing that a borrower requesting a modification must provide the servicer with virtually the same information required for a new loan and that servicers negotiate the modification terms with borrowers. HUD deferred to the CFPB on the question of whether modification specialists must be licensed, but noted that individuals involved in refinancing loans must be licensed. To date, the CFPB has not specifically addressed this question.

The principal argument against requiring modification specialists to be licensed is that it might hamper the number and efficiency of modifications provided to distressed borrowers. Individuals may be unwilling to provide the background data required for licensing, or may be unwilling or unable to complete the necessary education and testing. Servicers may resist the additional investment involved in obtaining, maintaining, and monitoring the licenses of their modification specialists. Moreover, as the economy recovers and defaults and foreclosures wane, fewer modification specialists are likely to be needed, making many of the licenses issued redundant.

The states are currently split on the issue. Approximately 30 states appear to require loan modification specialists to be licensed as loan originators. The remaining states either do not require licensing or have not taken a formal position on the issue — instead waiting for CFPB guidance.

### LOAN PROCESSORS AND UNDERWRITERS

The SAFE Act expressly addresses licensing of loan processors and underwriters, providing that a loan processor or underwriter who does not represent to the public that he or she can or will perform the activities of a loan originator is not required to be licensed.

The SAFE Act definition of “loan processor or underwriter” contemplates that processors and underwriters perform clerical or support duties under the direction and supervision of a state licensed or a federally registered loan originator. With this in mind, both the SAFE Act and the CSBS/AARMR state model law for implementation of the SAFE Act specify that an *independent contractor* may not engage in loan processing or underwriting, unless licensed as a loan originator.

Regulation H’s supplementary information section clarified that a loan processor or underwriter may be effectively supervised by a state licensed or a federally registered loan originator who directs, supervises, and instructs multiple loan processors and underwriters, perhaps even those working overseas, depending on the facts and circumstances. This supervisor need not be the direct or immediate supervisor of the processor or underwriter involved, but there must be an actual nexus between the direction, supervision, and instruction of such individual and the performance of the loan processor’s or underwriter’s duties.

Some lenders and servicers have attempted to comply with this rule by hiring individually licensed loan originators to direct, supervise, and instruct their loan processors and underwriters (both independent contractors and employees). Others no longer use independent contractors for loan processing and underwriting.

A number of states are reaching their own conclusions about whether loan processors and underwriters are loan originators for purposes of the licensing laws, notwithstanding the SAFE Act. For example, Connecticut requires loan processors and underwriters to be licensed, regardless of whether they are W-2 employees or independent contractors. Florida similarly requires loan processors to be licensed (although not as loan originators), but exempts in-house underwriters from licensure.

### INSURANCE PRODUCERS AND FINANCIAL ADVISORS

Insurance producers and financial advisors sometimes cross sell residential mortgage loan products offered by affiliated lenders. Regulation H defines the phrase “offers or negotiates terms of a residential mortgage loan for compensation or gain” (that is, the second part of the definition of “loan originator”) very broadly to include: receiving compensation (or expecting to receive compensation) for recommending, referring, or steering a

borrower or prospective borrower to a particular lender or set of residential mortgage loan terms, in accordance with a duty to or incentive from any person other than the borrower or prospective borrower.

Notwithstanding this broad definition, it is highly unlikely that Congress had insurance agents and financial advisors in mind when enacting the SAFE Act. Moreover, because the principal business of insurance agents and financial advisors has little to do with mortgage lending, it is unclear what benefits would be achieved by licensing them as loan originators. Insurance agents and financial advisors complete rigorous education, testing, and other requirements in connection with the various licenses that they need to offer insurance and investment advisory services, and the burden of additional licensing may not have corresponding consumer benefits.

Furthermore, if they are licensed as loan originators, insurance agents and financial advisors could solicit mortgage loans from the general public, potentially undermining originators who are more experienced, more involved with mortgage loan origination on a daily basis, and possibly more sensitive to the compliance obligations of the mortgage lending industry.

HUD specifically addressed licensing of financial advisors as loan originators in the supplementary information section to its final SAFE Act rule, clarifying that an individual cannot “offer or negotiate terms of a residential mortgage loan for compensation or gain” *unless* he or she *also* takes a residential mortgage loan application. Therefore, financial advisors (and by extension, insurance agents) should not be required to be licensed as loan originators if they do not take loan applications. However, HUD left it to individual states to determine whether financial advisors “offer or negotiate terms of a residential mortgage loan for compensation or gain.”

What’s troublesome here is the trend for states to adopt Regulation H’s definition of “offers or negotiates terms of a residential mortgage loan for compensation or gain” without taking into consideration the foregoing conclusions pertaining to financial advisors (which are easily overlooked in the supplementary information section to HUD’s final rule). In these states, licensing appears to be required for anyone who is paid or expects to be paid to merely recommend, refer, or steer a borrower to a specific lender.

Also notable is the handful of states (*e.g.*, Florida and New Hampshire) that require any person who “solicits” a residential mortgage loan for compensation or gain to be licensed as a loan originator. By using this broad term, it is possible that these states would require persons that proactively cross sell mortgage loan products to be licensed as loan originators, independent of whether their activities meet the definition of “offers or negotiates

terms of a residential mortgage loan for compensation or gain” set forth under Regulation H.

## HOUSING AND HOMEOWNERSHIP COUNSELORS

Housing counselors assist consumers with a variety of issues concerning homeownership. Some prepare residential mortgage loan applications and introduce consumers to different lenders. For many housing counselors, the income generated by homeownership counseling is unrelated to the outcome of their counseling efforts (appropriate outcomes in the counseling context may include a consumer’s decision not to buy or borrow).

HUD has stated that it is foreseeable that some housing counselors will engage in activities that subject them to loan originator licensing. However, under Regulation H, only those persons engaged “in the business” of loan origination are required to be licensed. Housing counselors whose activities are not conducted in a commercial context are not “in the business” and are thus not required to be licensed.

Accordingly, counselors employed by a government agency, housing finance agency, or *bona fide* non-profit organization are not required to be licensed. Others, such as those employed by commercial enterprises, would be required to be licensed if they take residential mortgage loan applications or offer or negotiate terms of loans for compensation or gain.

Several states’ licensing laws specifically exempt housing counselors. For example, the Washington Consumer Loan Act defines “mortgage loan originator” to exclude an individual employed by a HUD-approved counseling agency (but the exclusion does not apply if the employees of a housing counseling agency are required under federal law to be individually licensed as loan originators).

In June 2010, the California Department of Corporations determined that HUD-certified housing counselors and Habitat for Humanity volunteers and employees are not required to be licensed under the California Finance Lenders Law or the California Residential Mortgage Lending Act. The DOC emphasized that because HUD-certified housing counselors and Habitat for Humanity volunteers and employees do not charge customers for their services, their activities are not performed within the commercial context contemplated by the definition of “mortgage loan originator” under the CFLL and the CRMLA.

## INDIVIDUAL PROPERTY SELLERS

Many commenters on HUD’s proposed SAFE Act rule objected to licensing of individuals financing the sale of their own homes. Regulation H adopts this approach,

based on the absence of commercial and habitualness contexts in such transactions. However, this conclusion may not apply to individuals financing the sale of multiple properties owned by them (excluding the seller's own residence, vacation home/property, or inherited property). Here, the facts and circumstances involved will dictate whether licensing is required.

Nevertheless, even where the facts and circumstances tilt in favor of licensing, there are practical impediments to licensing individual property owners. To become licensed, a loan originator is typically required to be employed by a licensed or exempt mortgage lender or mortgage broker; licensing individual property owners would therefore create a corresponding obligation for them to obtain employment in the mortgage industry. Such employment may not be feasible in the current housing economy. Moreover, licensing of loan originators is resource-intensive from the point of view of licensing authorities (usually state banking departments). Review of applications and issuance of licenses to individuals whose activities are personal and non-habitual would divert scarce resources away from compliance monitoring of more significant players.

Some states have addressed this issue directly. For example, Mississippi recently amended the Mississippi S.A.F.E. Mortgage Act to specify its non-applicability to any person who finances in one calendar year not more than ten residential mortgage loans or 20 percent of his or her total residential units sold, whichever is greater. In Texas, there is an exemption from loan originator licensing for any owner of residential real estate who engages in no more than five seller-financed transactions in any 12 consecutive month period.

## WHAT'S NEXT?

As the foregoing examples illustrate, the nature of an individual's activities in a loan transaction, not the individual's job title, determine whether loan originator licensing is required. Regulation H addresses some, but not all, of the lingering concerns about the coverage of the term "loan originator." Since publication of Regulation H, the CFPB's SAFE Act-related efforts have been limited to the publication of SAFE Act examination procedures and a bulletin on transitional loan originator licensing.

Without more direction from the CFPB, non-uniform state licensing requirements will likely proliferate, ironically exacerbating the same regulatory issues that the SAFE Act was enacted to solve. Already, many of the "line calls" on loan originator licensing are addressed through enforcement actions and unofficial "positions," which have questionable precedential value and are typically based on specific fact patterns.

As the mortgage and foreclosure crisis eases, new types of participants in the mortgage industry will emerge, including those whose duties do not fall within the categories outlined above. Not every individual who touches a loan file or comes into contact with a prospective borrower can, or should, be licensed.

For now, the CFPB and state financial regulators would do well to articulate the public policy concerns associated with attempts to expand loan originator licensing to cover categories of individuals whose duties are merely ancillary to the production of mortgage loans.