

**A PRIMER FOR BANKERS
ON THE IMPLEMENTATION OF THE
SECURE AND FAIR ENFORCEMENT FOR
MORTGAGE LICENSING ACT**

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Soon, most likely before the end of 2010, every bank will be required to: (1) adopt procedures to register their residential loan originators with the Nationwide Mortgage Licensing System (NMLS); (2) identify all employees who should be classified as residential mortgage loan originators; (3) fingerprint and run new FBI criminal background checks on those employees; (4) review employment and credit histories for those employees; (5) see that all employees subject to registration do in fact register; and (6) maintain ongoing monitoring for compliance. These requirements do not just apply to new employees, but apply to all existing employees as well if those employees are residential mortgage loan originators.

A Brief Overview of SAFE and State Implementation Laws.

In 2008 Congress enacted the Secure and Fair Enforcement for Mortgage Licensing Act (“SAFE Act”). The legislation creates a comprehensive regime to register or license all residential mortgage loan originators in the United States. The SAFE Act divides all residential mortgage loan originators into two broad classifications: (1) employees of federally regulated depository institutions and their operating subsidiaries;

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and (2) loan originators of non-depository entities. Non-depository affiliated residential mortgage loan originators are required to be licensed. If a state enacts legislation to conform its licensing laws to the uniform standards required by the SAFE Act, the state will retain its authority to license residential mortgage loan originators. If a state fails to adopt the uniform standards, then HUD is authorized to assume the licensing responsibility for the non-conforming state. Among other requirements, SAFE mandates that states participate in a new national registry for mortgage loan originators, the Nationwide Mortgage Licensing System (NMLS). Employees of federally regulated depository institutions and their subsidiaries are not required to be licensed at the state level, but will be required to register through the NMLS. Employees of banks and their operating subsidiaries are designated in SAFE as “registered mortgage loan originators.”

THE MODEL STATE ACT

To assist the states in developing SAFE compliant legislation, CSBS/AARMR developed a model state act. The CSBS website contains a side by side comparison of the SAFE Act and the model Act. It can be found on line on the pages identified in the resources section of this paper. HUD which is responsible for certifying whether or not a state law is compliant with SAFE has issued a commentary on the model act that is available on line as well.

Does “and” Really Mean “or”?

The SAFE Act and the model act do contain some differences. For instance, compare the SAFE and model act definitions of a loan originator:

Under SAFE, a loan originator is defined as:

- (A) IN GENERAL.—The term “loan originator”—
 - (i) means an individual who—
 - (I) takes a residential mortgage loan application; ***and***
 - (II) offers or negotiates terms of a residential mortgage loan for compensation or gain;
 - (ii) does not include any individual who is not otherwise described in clause (i) and who performs purely administrative or clerical tasks on behalf of a person who is described in any such clause;

- (iii) does not include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless the person or entity is compensated by a lender, a mortgage broker, or other loan originator or by any agent of such lender, mortgage broker, or other loan originator; and
- (iv) does not include a person or entity solely involved in extensions of credit relating to timeshare plans, as that term is defined in section 101(53D) of title 11, United States Code.

However, the CSBS/Model Act which states are tending to follow reads:

(6) MORTGAGE LOAN ORIGINATOR—

- (a) IN GENERAL—The term “mortgage loan originator”—
 - (i) Means an individual who for compensation or gain or in the expectation of compensation or gain—
 - (A) Takes a residential mortgage loan application; ***or***
 - (B) Offers or negotiates terms of a residential mortgage loan;
 - (ii) Does not include an individual engaged solely as a loan processor or underwriter except as otherwise provided in MSL XX.XXX.040 (4);
 - (iii) Does not include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with [State] law, unless the person or entity is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator; and
 - (iv) Does not include a person or entity solely involved in extensions of credit relating to timeshare plans, as that term is defined in section 101(53D) of title 11, United States Code.

In its side by side comparison, CSBS/AARMR noted the change:

“The original S.A.F.E. language for this section presents a significant problem in the licensing of mortgage loan originators (MLOs). By using the word “and” between (A) and (B) instead of “or” S.A.F.E. effectively exempts an extremely large number of loan originators who have traditionally been licensed under state law. The MSL changes “and” to “or” to be consistent with most state laws. This change is consistent with a State’s ability to establish standards in legislation that exceed the standards in S.A.F.E.”

As we will see, the change from “and” to “or” is of significant import.

THE TEXAS SAFE IMPLEMENTATION LEGISLATION

In Texas, the SAFE implementation statute is HB 10 as passed by the 2009 Texas Legislature. HB 10 creates new Finance Code Chapter 180. Chapter 180 is based primarily on the Model State Act. However, Texas also passed two additional measures

that contain other modifications to its mortgage licensing regulations, HB 2774, relating to mortgage brokers, and HB 2779 relating to mortgage bankers.

Unless exempt Chapter 180 requires persons that meet the definition of a residential mortgage loan originator to become licensed by either:

- (a) the Office of Consumer Credit Commissioner (those originators working for regulated loan companies under Finance Code Chapter 342; persons working for manufactured housing financing entities licensed under Chapter 347 and certain personnel for motor vehicle sales under Chapter 348²); or
- (b) the Department of Savings and Mortgage Lending (mortgage brokers under Chapter 156 and mortgage bankers under Chapter 157).

An exemption from state licensing for bank employees and bank subsidiaries is found in Finance Code Section 180.003 (1) that exempts registered mortgage loan originators. A registered mortgage loan originator is defined in Finance Code Section 180.002(16):

- (16) "Registered mortgage loan originator" means an individual who:
 - (A) is a residential mortgage loan originator and is an employee of:
 - (I) a depository institution;
 - (ii) a subsidiary that is:
 - (a) owned and controlled by a depository institution; and
 - (b) regulated by a federal banking agency; or
 - (iii) an institution regulated by the Farm Credit Administration; and
 - (B) is registered with, and maintains a unique identifier through, the Nationwide Mortgage Licensing System and Registry.

THE NATIONWIDE MORTGAGE LICENSING SYSTEM (NMLS)

The central feature of SAFE is the launching of the Nationwide Mortgage Licensing System (NMLS). NMLS is a national internet based system to register mortgage lenders and individual mortgage loan originators. The concept was originated by state regulators

² No, this was not a typographical error. See discussion infra under "Is Your Car Loan Guy a Mortgage Loan Originator.")

in 2003 as a voluntary state compact. The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators joined together to implement this system even before passage of SAFE. In January of 2008, the system was activated with seven states participating (Iowa, Idaho, Kentucky, Massachusetts, Nebraska, New York and Rhode Island). The NMLS platform was developed and is operated by FINRA. The system in many respects is modeled to look like the FINRA system used to license security dealers and brokers (For instance in the securities industry, the company forms are called U-1's, and in NMLS the company forms are called MU-1's. The individual registrations for the security industry are called U-4's, and under NMLS are called MU-4's).

The licensing process for all states will eventually start with registering with the NMLS, completing a uniform application, and the obtaining of a unique identifier number. This unique identifier number, like one's social security number, is intended to follow the individual for his or her lifetime as the individual may transition from company to company and from state to state. The Federal Housing Finance Authority and FHA originally announced that this unique identifier will be required to be on each mortgage loan application taken on or after January 1, 2010. Obviously, not all originators will be on NMLS by that date. Thus, the date has been pushed forward to July 1, 2010. Look for the possibility of the date being extended again as NMLS attempts to grapple with the absorption of the large numbers of originators coming on line.

The system is not yet ready to handle registered mortgage loan originators, that is employees of banks and bank subsidiaries, and the federal banking agencies have yet to adopt final rules to regulate the registered mortgage loan originators.

SAFE COMES TO BANKING

The Federal Banking Agencies Draft Final Rule

In June of 2009, the federal banking agencies issued proposed rules for registered mortgage loan originators. In November of 2009, the federal banking agencies issued a final draft rule. Because the SAFE rule is considered to have a significant economic impact (i.e. regulatory costs of more than 100 million dollars), the rule cannot become final until it is reviewed by the Office of Management and Budget. As of mid-March 2010, OMB has not completed its review. However, most likely the draft final rule will be cleared and the draft final rule will become in fact the final rule. Federal banking agency staff are hopeful the rule will be final by mid-summer. That would be really nice considering that Fannie Mae and Freddie Mac will be requiring that all mortgage loan applications taken after July 1, 2010 to include the mortgage loan originator's unique identifier.

QUESTIONS AND ANSWERS FOR BANKERS

ABOUT SAFE

The following questions and answers are based upon the draft final rule for the FDIC which will become new subpart B of 12 CFR Part 365. The draft final rule, including the preface and commentary can be found on-line at the NMLS site through a link under the tab "Federal Registration."

1. What is a registered mortgage loan originator?

This is the term used for employees of a bank or a bank subsidiary who perform the duties of a mortgage loan originator. Under SAFE all mortgage loan originators must be either state licensed or registered. Employees of a bank or a bank subsidiary are not required to have a state license, but are required to register with the Nationwide Mortgage License System.

2. Who is a mortgage loan originator?

Under the SAFE act a mortgage loan originator is an individual who *both* takes a residential mortgage loan application and offers or negotiates terms of a residential mortgage loan for compensation or gain. (As noted, the CSBS/AARMR model act defines an originator as one who either takes an application *or* negotiates or offers rates and terms for a residential mortgage loans. For bank employees it is the federal SAFE that is key, and the banking agencies recognize that an originator is one who engages in both taking the application and offering/negotiating terms. Caveat: taking an application is broadly defined and includes receiving an application from another bank employee or third person for the purpose of offering or negotiating loan terms to a consumer.)

3. Will loan processors and other clerical personnel be required to become registered mortgage loan originators?

An individual who performs only certain clerical or administrative functions on behalf of a registered mortgage loan originator are not covered. Sec. 365.102(2) (i). Appendix A of the draft final rule contains a detailed list of examples of activities that will require an employee to be registered and activities that will not require the employee to be registered.

4. How is residential mortgage loan defined?

A residential mortgage loan is any loan primarily for personal, family, or household use that is secured by a dwelling (using the Truth in Lending Act definition for dwelling) or residential real estate upon which is constructed or intended to be constructed a dwelling. The term covers virtually all such loans including home equity lines of credit and reverse mortgages. Significantly, the term also includes refinances.

5. Does this mean that loss mitigation and loan servicing employees will be required to register?

The federal banking agencies specifically declined to incorporate an exclusion for loan servicing personnel. In reaching the decision the agencies stated that it is the activities performed by the employee and not the employee's title or job classification that

determines whether the employee must register. The agencies noted that a loan servicing employee engaged solely in bona fide cost free loss mitigation efforts which result in reduced and sustainable payments for a borrower would not meet the definition. But loss mitigation personnel would be required to register if they *both* take an application *and* negotiate or offer terms for a residential mortgage loan. This muddled language in the preface to the rule probably should lead to a decision to register many loan servicing or loss mitigation personnel.

6. When do the employees of banks and their subsidiaries have to be registered with the Nationwide Mortgage Licensing System?

Employees who are subject to registration must be registered no later than 180 days after NMLS opens the registration to employees. Once the draft rule becomes final, NMLS will have to modify its software and operating system. The current system is operating for state licensing of originators. It is unclear how long after the draft rule becomes final, NMLS will need to modify the system.

7. What are the bank's obligation regarding registration?

Banks must: a) establish procedures for implementation of SAFE; b) create its own bank record with the NMLS (an MU-1); c) require employees who act as mortgage loan originators to register; d) prohibit any employee from acting as a mortgage loan originator if the employee does not register or maintain her registration; e) review the criminal and personal histories of its mortgage loan originators and take appropriate action; f) monitor and test for ongoing compliance.

8. How does an employee register?

After the bank or subsidiary has completed the MU-1 for the institution, individual employees may then register. Registration is computer based. The employee registration form is designated as a MU-4. The employee will provide basic identification information; a set of fingerprints for an FBI criminal history check; the financial services employment history for the employee for the last ten years; information related to any financial related criminal offenses (including deferred adjudications); any information

relating to civil actions or administrative actions relating to the employee's financial services related activity.

9. Will the NMLS Registry review and pass on the criminal and personal histories?

No. This is the responsibility of the bank. The information submitted to the registry will be also available to the bank. The bank will receive the FBI criminal history. The bank must then determine whether the employee should serve as a mortgage loan originator based upon the criminal history and personal history information. The proposed regulations have not addressed whether banks should apply the very strict criminal history disqualifications that apply to state licensed mortgage loan originators, but the regulations do insist that at a minimum the bank apply the much more lenient (believe it or not) provisions of FDIC Section 19. Because the FBI fingerprinting procedure is quite thorough, banks are likely to find some of the reports surprising.

10. Is registration a one-time thing?

No. The registration must be renewed annually. The renewal period will be November and December of each calendar year.

11. Is my Car Loan Guy a Mortgage Loan Originator?

Possibly yes, if he makes loans secured by a travel trailer or RV that is used as a consumer's residence. Both the SAFE Act and the state model act define a residential mortgage loan as follows:“(11) RESIDENTIAL MORTGAGE LOAN—The term ‘residential mortgage loan’ means **any loan primarily** for personal, family, or household use that is **secured by a** mortgage, deed of trust, or other equivalent **consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act)** or residential real estate upon which is constructed or intended to be constructed a dwelling (as so defined).” CSBS/AARMR notes in its commentary on the model act that: “Pursuant to Regulation Z, §226.2(a) (19): Dwelling means a residential structure that contains 1 to 4 units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, *mobile home, and trailer, if it is used as a residence.*”

12 Is there an exception for employees who only make an occasional mortgage loan?

The draft final rule does provide a de minimis exception for employees that have acted as a mortgage loan originator for 5 or fewer residential mortgage loan within the previous 12 months if the employee has never been registered. This may mean that once an employee has been registered, he or she must have a current registration in order to act as a mortgage loan originator regardless of current volume of activity. Also, the de minimis exception cannot be used in a way to evade the registration requirements. Presumably, this means that taking turns among officers in a department so that no one does more than 5 in a 12 month period would be suspect. This de minimis exception may, however, give relief from having to register the car loan guy.

13. What must the bank policy and procedures contain?

At a minimum the procedures must have the following:

- (a) Establish a process for identifying which employees of the bank are required to be registered mortgage loan originators;
- (b) Require that all employees of the national bank who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this subpart and be instructed on how to comply with such requirements and procedures;
- (c) Establish procedures to comply with the unique identifier requirements
- (d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;
- (e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;
- (f) Provide for independent testing for compliance with this subpart to be conducted by bank personnel or by an outside party;

- (g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this subpart, or the bank's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and
- (h) Establish a process for reviewing employee criminal history background reports received from the Registry and taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

14. What about that unique identifier again?

Again this is the personal and permanent identification number of the mortgage loan originator. When the regulation is fully implemented, the unique identifier will be required on each mortgage loan application. Fannie and Freddie currently plan to start requiring it on any loan applied for on or after July 1st of this year. In addition the draft final rule requires that the unique identifier be provided to the consumer a) when requested; b) prior to the person undertaking activities of a loan originator; and c) in the initial written or electronic communication with the consumer. This latter requirement is cause for banks to now begin thinking how their systems will be reconfigured to make this disclosure.

15. What about employees of bank holding company affiliates that are not bank subsidiaries?

The SAFE Act only provides for the registration of bank employees and employees of bank subsidiaries that are regulated by a banking agency. If an entity is a non-depository affiliate of a bank, but is not a subsidiary of the bank itself, the employees will be required to be licensed at the state level.

The Licensing of Attorneys under SAFE

It is possible that attorneys who represent lenders and are compensated by a lender in connection with residential mortgage loan may be required to be licensed as mortgage loan originators. Attorneys are not specifically mentioned anywhere in the SAFE Act.

However, the model act contains the following exemption

3) EXEMPTION FROM THIS ACT—the following are exempt from this Act:

- (d) A licensed attorney who negotiates the terms of a residential mortgage loan on behalf of a client as an ancillary matter to the attorney's representation of the client, **unless the attorney is compensated by a lender, a mortgage broker, or other mortgage loan originator or** by any agent of such lender, mortgage broker, or other mortgage loan originator.

Here is what this could mean: If an attorney ancillary to the representation of a lender in a foreclosure proceeding or a bankruptcy negotiates the terms of reinstatement or modification of a mortgage loan, it appears that the model act could require the attorney to be licensed as a mortgage loan originator. Attorneys in at least one state (Texas) have attempted to negate this possibility by revising the language in its SAFE implementation statute to read as follows (Finance Code Sec. 180.003(3) :

“a licensed attorney who negotiates the terms of a residential mortgage loan on behalf of a client as an ancillary matter to the attorney's representation of the client, unless the attorney:

- (A) takes a residential mortgage loan application; **and**
- (B) offers or negotiates the terms of a residential mortgage loan;”

The thinking is that by tying the negotiation of loan terms back to the taking of the application, the state exemption will pass muster under SAFE because a loan originator under SAFE is defined by the use of the conjunction “and” and not the term “or”. (I told you that the difference between “and” and “or” might be important!).

RESOURCES FOR SAFE

The NMLS maintains a very useful website at
<http://mortgage.nationwidelicencingsystem.org>

CSBS maintains a SAFE information page at
http://www.csbs.org/AM/Template.cfm?Section=SAFE_Act

This page contains a link to the model act, the HUD commentary, legislative summaries, and other information.

HUD also has information available online, including its FAQ's at <http://www.hud.gov/offices/hsg/ramh/safe/sfea.cfm>

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