

Loan Originator Changing Rules: SAFE Act Transitional Temporary Authority

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James W. Brody, Esq.

As the Chairman of the Mortgage Banking Practice Group, Mr. Brody actively manages all the complex mortgage banking litigation, mitigation, and compliance matters for Johnston Thomas and its diverse clientele.

Being one of the founding and managing attorneys for his prior mortgage banking firm, as well as having practiced law for close to 20 years, with nearly 15 of those years being spent in the mortgage banking industry, Mr. Brody has been instrumental in the firm's development and in its continued success.

Mr. Brody has successfully resolved hundreds of mitigation and litigation cases that involve complex mortgage fraud schemes, as well as large-scale repurchase and/or make-whole disputes, in connection with loans that were securitized and/or sold to third parties (e.g., Lehman Bros., Aurora, FNMA, Freddie Mac, ResCap, RMBS Trusts, CitiMortgage, JPMorgan Chase, and more).

Mr. Brody's experience centers on those legal issues that arise during and through loan originations, loan purchase sales, loan securitizations, foreclosures, bankruptcies, and repurchase and indemnification claims.

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ATTORNEYS AT LAW, PC

Johnston Thomas is a full suite boutique law firm, which amongst other practices such as real estate and commercial litigation, has a nationally recognized Mortgage Banking Group (“MBG”). With an experienced team of mortgage banking lawyers (including senior litigation attorneys, former in-house General Counsel and in-house Compliance Counsel from a well-known bank and mortgage company, etc.), certified fraud examiner(s) and forensic underwriter(s), and an extremely competent support staff, all of whom are dedicated to aggressively and competently serving the needs of our valued clientele, Johnston Thomas’ MBG is known all across the country for the experience and results that it brings to the areas of regulatory compliance, mortgage banking litigation, and a broad range of mitigation services.

Amongst the many legal services Johnston Thomas offers the mortgage banking industry (e.g., brokers, lenders, servicers, vendors and more), such include, but are in no way limited to, as follows:

- Mortgage Repurchase and Make-Whole Indemnification Litigation and Mitigation (e.g., Secondary Market Investors, Agencies, Bankruptcy Trustees, etc.);
- Mortgage Industry Litigation (e.g., Servicer and Sub-Servicer Disputes, 3rd Party Fraud Recovery, CPL and Title Policy Actions, Appraiser E&O Claims, Loan Officer Actions, LOS Disputes, etc.);
- Mortgage Repurchase and Make-Whole Alternative Dispute Resolution (e.g., Arbitration, Mediation, etc.);
- Regulatory Compliance, Administrative and Business Services (e.g., Mock Audits, LO Compensation, MSAs, Licensing, CA Dep’t of Business Oversight, HUD Review Board, etc.); and
- Transactional Matters (e.g., Drafting and Negotiating Broker and Correspondent Loan Purchase Agreements, Mergers & Acquisitions, etc.).

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GUEST SPEAKERS

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THE CMLA

The Community Mortgage Lenders of America is a Washington D.C. based Mortgage Advocacy Association exclusively representing midsize and small community-based independent mortgage companies, banks, and credit unions.

THE CMLA is dedicated to strong representation ensuring the concerns and interests of our members are heard as policy makers address pivotal issues in housing finance regulations.



THE CMLA

Members, if they so desire, frequently participate on industry panels, testify before and interact with Congress and the Agencies, as well as provide crucial information by participation on task forces for a multitude of mortgage related topics. The CMLA also assists its members with casework at HUD, VA, Rural Housing, as well as the GSEs. If a member has a problem with an agency, we are here to help.



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Webinar Agenda

- CMLA and LO Transitional Licensing
- License Act Defined & Requirements
- Loan Originator Requirements.
- Intentional & Unintentional consequences
- Significance of Transitional License implementation
- Temporary Authority Regulation
- Conditions of Temporary Authority
- Transitional Authority & Compensation
- Applying the Tools to Transitional Licenses
- Can I pay my LO as an Independent Contractor?
- Loan Originator Paying for Unanticipated Cost Increases
- Quality Loan Factor in LO Comp Plans
- Effectives on Compensation Agreement Reasonable Time Periods
- What about UDAAP?
- Current LO Comp Regulation and Enforcement
- Lender Risk, Control, and Preparedness



THE CMLA

Loan Officer Transitional Licensing

- Nonbanks struggled with existing law, as they could not recruit bank LOs (due to training and registry requirements.)
- Grassroots effort to lobby Congress for a solution to not crimp nonbank production/customer service.
- Early solutions by other trade groups: law to require bank LOs licensing
- The CMLA: that won't fly, we need a transitional license.
- Broad Coalition inserted into Senate Reg Relief bill
- The rest, as they say, is history!



The Act Defined:

Current Requirements:

The Loan Originator Transitional Temporary Authority Rule amends The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)

The SAFE Act requires individuals engaging in the business of a residential mortgage loan originator first obtaining and maintain annually either:

- Federal registration as a registered mortgage loan originator and a unique identifier, or
- A state license and registration as a state-licensed mortgage loan originator, and a unique identifier (state licensing/registration)

The objectives of the SAFE Act include

- improving the flow of information
- increased accountability and tracking of MLOs;
- consumer protection;
- supporting anti-fraud measures
- and providing consumers with easily accessible information



Originator Requirements:

Any individual who, for compensation or gain, takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan application is considered to be and must be licensed or registered as, a Mortgage Loan Originator.

The SAFE Act defined Registered vs Licensed.



Originator Requirements:

Mortgage Loan Originator Requirements

A licensee must:

- Be registered within the Nationwide Mortgage Licensing System (NMLS)
- Take a 20 Hour Pre Licensing Course,
- Pass an exam and
- Meet background check criteria.

Depository Loan Originator Requirements

Individuals working for depository institutions must:

- Be registered within the Nationwide Mortgage Licensing System (NMLS)



Originator Requirements:

	LICENSED	REGISTERED
Have Personal License	Yes	No
Registered in NMLS	Yes	Yes
FBI Background	Yes	No
Fingerprinted	Yes	No
Surety Bonded	Yes	No
Pre-Employment education	Yes	No
Annual continuing education	Yes	No
Personal Credit checked	Yes	No
State Test	Yes	No
Federal Test	Yes	No
Complaint mechanism's	Yes	No
Licensing fees and renewals	Yes	No
Loan Officer Designation	MLO	RMLO

NMLS = Nationwide Mortgage Lender System and Registry (Tracking Number)

MLO = Mortgage Loan Officer (Licensed and Trained)

RMLO = Registered Mortgage Loan Officer (registered)



Consequences:

- Loan officers who work for depository businesses don't have to pass all of the NMLS state licensing requirements.
- A loan officer who works for a depository lender just can't start working for a non-depository lender.
- A LO who moves between states or from a bank to a nonbank is required to wait for a new license before they can begin originating at their new job.
- Disincentive for a competitive or mobile labor market.



Years in the Making :

Years-long push from the mortgage industry.

- First Call for Transitional Licensing in 2012.
- Uniform State Test (4/1/14 -8/1/18)
- States Laws to allow for state-to-state MLO transitions and federal to state regulated entities.
- Ohio, Virginia and North Carolina New Hampshire and South Carolina

During 2018, MBA successfully led the advocacy campaign to amend the federal Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act of 2008 to provide a 120-day temporary authority period for MLOs to originate mortgage loans.



Significance of the Change:

Later this year, when the new Licensing rule takes effect, several of the labor market barriers may be eliminated.

- Non-bank lenders-especially small lenders will have the ability to compete for additional talented MLOs
- MLOs will have the ability to work for any employer-bank or non-bank-that offers them the best chance to earn income and succeed in their career.
- More MLOs will be completing pre-licensing education and taking a standardized test -- leading to a better-qualified MLO workforce, a larger number of test-takers and therefore greater compliance with lending laws.



The Law:

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (S. 2155) amended the federal Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act of 2008

- provides for a 120-day temporary transitional authority period for a bank mortgage loan originator (MLO) moving to a non-bank lender, or for MLOs already working for a non-bank lender seeking licensure in another state.
- Individuals with temporary authority will have NMLS licensing status as “authorized to conduct business” in the state
- Lenders “must monitor” the status of their LOs’ licensing status and temporary authority to originate.
- Mandates that states implement transitional authority by November 24, 2019.



The Law: Eligibility

Permits Eligible MLO's to Continue Originating Mortgages while Completing State-Specific Requirements for Licensure (Testing & Education)

1. MLO's changing from depository institution to state-licensed mortgage company
2. Licensed MLOs applying in another state

Eligible MLO's

- Previously Licensed for 30 days or Previously Registered for 365 days
- W-2 Employee of Licensed Company
- No Disqualifying Criminal History
- Never had License Denied, Revoked or Suspended



The Law: Timing

When does Temporary Authority Begin?

- Beginning November 24, 2019
- Applicant Must Complete Application Process
- Company Must Sponsor the Applicant

NMLS Requirements

- No Separate Application
- MLO applies for a license and, if eligible, will automatically receive temporary authority
- Eligibility requirements will be programmed for review within NMLS.
- An individual with temporary authority will show as being “authorized to conduct business” in the state – the actual license status will not be updated until the state makes a decision with regard to the license application.

The new amendment to the law does not include a limitation for the number of states where an MLO applicant can apply for a license and become eligible to operate under Temporary Authority.



Scenario: Timing

If the MLO submits the application for license on Monday, but the State doesn't begin their review until Tuesday, when did Temporary Authority Begin?

Temporary Authority would begin on Monday if the system is able to automatically verify eligibility.

If manual state review is required to verify the eligibility portions of the review, Temporary Authority would not begin until completion of that state review.



The Law: Timing

An individual with temporary authority may originate loans as if he/she possesses a license in that state. The individual and the loans originated by that individual will be subject to the same rules and regulations as applicable to a licensed MLO.

When does Temporary Authority End?

1. MLO Withdraws the Application
2. Company Withdraws Sponsorship
3. State Denies or Issues Intent to Deny
4. State Grants the License, or
5. Application listed as incomplete 120 days after submission NMLS



The Law: Timing

At the End of the 120 days, if an Application is Complete (including Testing and Education) and the Agency has not yet made a Decision on the Application, Temporary Authority exists until the Agency Acts on the Application.

Reminder:

Complete Application must include:

1. Completed Individual Licensing Form (MU4);
2. Explanation and Supporting Documentation for any “Yes” answers to a disclosure question;
3. Receipt of Criminal History Record Check from the FBI;
4. Authorization for a Credit Report to be obtained; and
5. Any state-specific document required as part of an MLO license application in the Application State.



The Law: Other Considerations

- Temporary Authority not applicable for MLO's who are licensed and changing employers within the same state.
- There are additional responsibilities and obligations for lenders. Lenders “must monitor” the status of their LOs' licensing status and temporary authority to originate. If an LO's application is denied, the lender “must reassign any active loans in the pipeline originated by that MLO to a licensed MLO in that state.”
- Lenders can face enforcement action by the state if it is found that a mortgage lender knew of or should have known of a disqualifying event that would cause a license application to be denied, and failed to disclose such event.



Scenario

A former bank originator joins your team and applies for their first MLO license on NMLS ...

Then posts to Linked In, Twitter, Facebook and Instagram that they are now licensed with your company and you have the lowest rates in the states and free appraisals

Has your new MLO violated any laws or regulations?



Scenario:

Originator Responsibility:

“shall be subject to the requirements of this title and to applicable State law to the same extent as if that individual was a State-licensed loan originator licensed by the application State.”

Company Responsibility:

“shall be subject to the requirements of this title and to applicable State law to the same extent as if that individual was a State-licensed loan originator licensed by the application State.”



Prepare, Prepare, Prepare

Risk Assessment

- Contact your LOS Provider
- Contact your Investors
- Contact Loan Evaluation providers
- Contact your Quality Control providers
- Review Policy and Procedures for:
 - Training Priorities
 - Processing, U/W & Closing
 - Company Policies including Advertising
 - Oversight and Quality Control
 - Investor and Regulator Reporting
 - Licensing Sponsorship and Withdrawal of Sponsorship

Evaluate ALL & Share before the effective date of November 24th.



Questionable Practices

- **Paying an LO as an Independent Contractor**

“For purposes of § 1026 . . . the individual loan originator’s total compensation consists of the sum total of: (1) all wages and tips reportable . . . on IRS form W-2 (or, if the individual loan originator is an independent contractor, reportable compensation on IRS form 1099-MISC) . . .”

36(d)(3)(v)

IRS Control Test

Independent Contractor

Payer directs result only

Employee

Employer directs what and how

Loan Originator ≠ Independent Contractor



Utilizing All Tools Available

Compensation paid or received according to these “Safe Harbor” methods is not based on transaction terms or proxies for transaction terms:

1. The loan originator’s overall dollar volume (total dollar amount of credit extended or total number of transactions originated), delivered to the creditor.
- 2. The long-term performance of the originator’s loans.**
3. An hourly pay rate based on the actual number of hours worked.
- 4. Loans made to new customers versus loans to existing customers.**
5. A payment that is fixed in advance for every loan the originator arranges for the creditor (for example, \$600 for every credit transaction arranged for the creditor, or \$1,000 for the first 1,000 credit transactions arranged and \$500 for each additional credit transaction arranged).
- 6. The percentage of the loan originator’s applications that close.**
- 7. The quality of the loan originator’s loan files (for example, accuracy and completeness of the loan documentation) submitted to the creditor.**



Permissible Comp Structures

- **Different Compensation Structures for Different LOs**
 - Not based on loan terms
 - Not paid by both borrower and lender
- **Toggling between borrower and lender paid compensation**
- **Minimum/Maximum**
 - Ex: 1% of loan amount on all loans but not less than \$1000 or greater than \$5000 for each loan
- **Guaranteed Specific Benchmark Bonus**
 - Not based on loan terms
 - Not subject to 10% limit
- **Sign-on and Retention Bonuses**
 - Not based on profits
 - Budget in advance



Permissible Comp Structures (cont.)

- **Pick a Plan Structures**

Option 1-No Assistant

Monthly Volume ~non construction loans~	Commission in bps
< \$1,000,000	125 bps
≥ \$1,000,000 & < \$2,000,000	125 bps
≥ \$2,000,000	125 bps

Option 2 – Assistant

Monthly Volume ~non construction loans~	Commission in bps
< \$1,000,000	115 bps
≥ \$1,000,000 & < \$2,000,000	110 bps
≥ \$2,000,000	105bps



Permissible Comp Structures (cont.)

- **Designated Tax-Advantaged Plan**
 - Meets specific IRS guidelines like 401(k)s
 - Contributions cannot be directly or indirectly based on the terms of an individual LO's transactions



Permissible Comp Structures (cont.)

- **Non-deferred Profits-based Compensation Plan**
 - **Contributions cannot be directly or indirectly based on the terms of an individual LO's transactions**
 - **AND...**

Capped at 10% of
LO's total comp for
same period

OR

Individual LO was an LO for 10 or
fewer transactions during the
preceding 12-month period

- **Can include affiliate profits**
- **Awards of merchandise, services, trips, etc., count toward 10%**



P&L Branch Exercise

- **Scenario**
 - Producing Branch Mgr
 - $\text{Comp} = \text{Revenue to branch less OH/Costs}$
 - Balance to BM
- **Analysis**
 - Loan Originator? Yes
 - Is comp directly/indirectly based on terms of multiple transactions by multiple LOs? Yes
 - Permitted non-deferred plan? No
 - Violation
 - Consider fixed % on originations and cap bonus at 10%



Prohibited Compensation Structures

- **Varying LO Comp by Loan Product**
Loan Product = Bundle of Terms
- **Compensation Pools**
Terms of multiple transactions by multiple LOs
- **Point Banks**
CFPB: “there should be no circumstances under which point banks are permissible” Rule Preamble
- **Sliding Scale %**
1% for loans \geq \$300K, 2% on \$200K-\$300K, 3% for loans $<$ \$200K
- **Basing LO Comp on Sold vs. Portfolio**
Proxy



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Proxy



Proxy of a Loan Term

- Consistently varies with a term or terms of the transaction over a significant number of transactions
- LO has the ability, directly or indirectly, to add, drop, or change the factor when originating the transaction

EXAMPLES

QM vs. Non-QM

FHA vs. Conventional

Bond Program vs. Non-bond Program

DTI/LTV

CRA vs. non-CRA



Not a Proxy of a Loan Term

- **Overall Dollar Volume**
- **Long Term Performance of Loans**
- **Hourly rate for actual hours worked**
- **Existing Customer vs. New**
- **Fixed Fee Per Unit**
- **Percentage of Submitted that Close**
- **Quality of loan files (such as accuracy and completeness)**



Questionable Practices

- **Clawbacks for Quality of the LO's Files**
 - Not contemplated by safe harbor for loan quality
 - Build quality loan factors into your LO comp structure
- **EPO/EPD Clawbacks**
 - Pattern of error? Could be a proxy
 - Compensation should be set in advance
 - May run contrary to state employment laws
- **Frequent Revisions to Compensation Plans**
 - No more than once every 6 months
 - Document the reason for the change
- **Paying LOs differently for purchases vs. refinances**
 - No express carve-out
 - Bundle of terms



Proceed with Caution

- **LO Comp Reduction to Cover Rate Lock Extension Fee or Cure Tolerance Violation**
 - Unforeseen
 - Document the decrease and the reason for it
- **Varying Comp by State**
 - Does one state have lower credit scores?
 - Higher interest rates?
 - Might be a proxy
- **Source of Lead**
 - Probably not a proxy
 - Avoid RESPA kickbacks



What About UDAAP ?

- Unfair Deceptive Abusive Acts or Practices
 - Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd- Frank Act), all covered persons or service providers are legally required to refrain from committing unfair, deceptive, or abusive acts or practices (collectively, UDAAPs) in violation of the Act..
 - Often UDAAP is a tool the CFPB uses when it finds an unsavory practice that does not fit neatly into its other rules.



THANK YOU!

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