February 24, 2010

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W.
Room 10276
Washington, D.C. 20410-0500

RE: Comments on Docket No. FR-5271-P-01
SAFE Mortgage Licensing Act; HUD Responsibilities under the SAFE Act

Dear Sir/Madam:

The Conference of State Bank Supervisors ("CSBS")[1] and the American Association of Residential Mortgage Regulators ("AARMR")[2] (collectively, "state regulators") commend the effort by the U.S. Department of Housing and Urban Development (HUD) with respect to its Proposed Rule, "*SAFE Mortgage Licensing Act; HUD Responsibilities Under the SAFE Act*" ("Proposed Rule"). We appreciate the opportunity to comment on the Proposed Rule.

INTRODUCTION

Since the enactment of The Secure and Fair Enforcement Mortgage Licensing Act of 2008 ("SAFE Act" or "Act"), state regulators have worked with HUD to fulfill the mandates of the Act including the requirements that:

- states establish minimum standards for the licensing or registration of all mortgage loan originators, and
- all licensing and registration functions be conducted through the Nationwide Mortgage Licensing System & Registry ("NMLS").

[1] CSBS is the nationwide organization for state banking, representing the bank regulators of the 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands, who oversee approximately 6,000 state-chartered financial institutions. CSBS also is responsible for improving the quality of state bank supervision by providing department performance evaluation and accreditation programs and supervisory education/training programs for state banking department personnel.

[2] AARMR is the national organization representing state residential mortgage regulators. AARMR's mission is to promote the exchange of information between and among the executives and employees of the various states who are charged with the responsibility for the administration and regulation of residential mortgage lending, servicing and brokering.

Throughout this process, state regulators and HUD have forged a unique model of state-federal partnership that has worked proactively and successfully to implement the stated objectives of the SAFE Act.

After the SAFE Act's enactment, state regulators immediately began the work of implementing the SAFE Act, including development of a model state law to implement mortgage regulation that incorporated the minimum standards in the SAFE Act[3]. The legislation included standardized definitions, national pre-licensure and continuing education and testing requirements, and financial responsibility and criminal background standards for mortgage loan originators. In a January 5, 2009 notice in the Federal Register[4], HUD formally stated that "HUD has reviewed this model legislation and finds that it meets the minimum requirements of the SAFE Mortgage Licensing Act."

Relying on the CSBS/AARMR Model State Law, state legislatures moved in a focused and efficient manner to enact SAFE Act-implementing legislation in 49 states, the District of Columbia, and the Virgin Islands within one year of the Act's passage. The few remaining jurisdictions have developed legislative proposals that will be considered during the 2010 legislative sessions. Thus, mortgage licensing laws are far more uniform today than ever before and the state-federal partnership has established a permanent foundation for better mortgage supervision.

In addition to mandating state laws and regulations to meet certain minimum requirements, the SAFE Act contained seven specific mandates for NMLS. To date, five of these mandates have been implemented. These include:

- **Establishing protocols for the issuance of unique identifiers.** This mandate was accomplished at system launch and to date, over 13,000 mortgage companies and 87,000 mortgage loan originators are operating with an NMLS Unique ID number.

- **Receiving and processing of fingerprints for national criminal history background checks for all residential mortgage loan originators.** An automated, streamlined federal criminal background check process was implemented in NMLS on January 25, 2010. This system includes a national network of over 850 sites for capturing fingerprints electronically with the ability for a mortgage loan originator to provide prints and request a single, criminal background check in any state or U.S. territory for a license application or applications in one or more other states or U.S. territories. In the first two weeks of operations, over 5,800 mortgage loan originators requested criminal background checks through this automated process. These criminal histories will be reviewed by state regulators against the SAFE Act standards.

[3] The CSBS/AARMR Model State Law can be found online at: http://mortgage.nationwidelicensingsystem.org/safe/Pages/default.aspx.

[4] A copy of S.A.F.E. (SAFE) Mortgage Licensing Act; Notification of Availability of Model Legislation can be found online at: http://mortgage.nationwidelicensingsystem.org/safe/Pages/default.aspx.

- **Developing and administering a qualified written test.** NMLS worked with test development professionals to launch the national component of the SAFE Test on August 1, 2009. Developed with input from industry and regulatory experts, this entry level test evaluates an individual's knowledge of the basic federal law, mortgage product, ethics, and business practices necessary to be a professional mortgage loan originator. To date, over 6,400 individuals have taken the test. NMLS has facilitated the development of state component tests and to date have developed 30 state tests with over 3,800 individuals taking the test.

- **Review and approval of pre-licensure and continuing education courses.** NMLS has developed an education provider and course approval process that launched in July 2009. NMLS-approved providers can offer NMLS-approved courses that meet the SAFE Act pre-licensure and continuing education requirements in all states. To date, there are 172 NMLS-approved course providers offering 360 NMLS approved courses and over 108,000 classroom hours of approved education have been taken by individuals.

- **Providing public access to licensing information on all residential mortgage licensed loan originators.** On January 25, 2010, NMLS launched *NMLS Consumer Access* (http://www.nmlsconsumeraccess.org)**,** a website that provides consumers, free of charge, with basic information concerning state licensed mortgage companies, branches and mortgage loan originators.

The two remaining NMLS mandates are:

- **Development of a Mortgage Call Report.** Prior to the SAFE Act, nearly all states required companies to submit financial statements and 38 states required an annual report of mortgage activity. A working group of state regulators has developed a discussion draft of a Mortgage Call Report that seeks to replace these requirements with a uniform set of requirements that will provide state regulators with the information necessary to better monitor the status of non-depository mortgage companies. The Mortgage Call Report is proposed to be completed by any company that employs licensed mortgage loan originators. State regulators have put out for public comment a discussion draft of the NMLS Mortgage Call Report, which is available on the NMLS Resource Center. The NMLS Mortgage Call Report is expected to be available in 2011.

- **Availability of publicly adjudicated disciplinary and enforcement actions.** A working group of state regulators has begun drafting the policies and processes necessary to make public enforcement actions taken by regulators against mortgage companies and mortgage loan originators available on *NMLS Consumer Access*. The functionality is expected to be available in 2011.

State regulators are proud of the legislative, regulatory, and system development mandates that have been fulfilled in just 18 months since the passage of the SAFE Act. We recognize that this success depended on the fact that, far before the passage of the SAFE Act, state regulators began working together on NMLS and a modern coordinated system of mortgage supervision. We look forward to working with HUD in furthering this system and developing an effective state-federal model of supervision that benefits from the efficiencies of a nationwide collaborative effort and the precision and judgment of local decision-making.

The comments on the Proposed Rule below are offered in the spirit of continuing to work with HUD on this framework.

DISCUSSION

Our comments on the HUD Proposed Rule are divided into two parts. Part I addresses some of the issues discussed in the Preamble for which HUD specifically requested comments. Part II contains a section-by-section review and analysis of the Proposed Rule where state regulators suggest technical or specific substantive changes.

I. Issues Raised in the Preamble

A. Individuals Performing Loan Modifications

In Section L of the preamble to the Proposed Rule, HUD specifically asks for comments on HUD's existing inclination to require individuals who modify residential mortgage loans to be licensed as loan originators. Given the importance of providing foreclosure prevention opportunities during this time of financial crisis, state regulators believe providing feedback on this position requires detailed discussion of the various entities involved in loss mitigation today.

In the last two years, this country has faced an unprecedented level of foreclosures and homeowners struggling to make their mortgage payments. States have been on the front-lines of the foreclosure crisis and have responded through individual state initiatives[5] and through multi-state efforts to prevent unnecessary foreclosures, for instance through the efforts of the State Foreclosure Prevention Working Group.[6]

While some progress has been made in avoiding unnecessary foreclosures, state regulators have been extremely disappointed and frustrated with the pace of loss mitigation efforts of major servicers. Servicers were slow to recognize the depth and extent of the foreclosure problem and have failed to implement effective loss mitigation programs to prevent foreclosures that would be in the best interests of both investors and homeowners. This failure has harmed not only homeowners and the financial interests of investors, but also has devastated neighborhoods and communities across the nation and increased the burdens upon local governments.

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[5] *See* 2009 State Residential Mortgage Foreclosure Laws, NGA Center for Best Practices (Jan. 13, 2010), *available at:* http://www.nga.org/Files/pdf/1001FORECLOSURELAWS2009.PDF.

[1] Analysis of Mortgage Servicing Performance, Data Report No. 4, State Foreclosure Prevention Working Group (Jan 2010), *available at:* http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport4Jan202010FINAL.pdf

[6] The State Foreclosure Prevention Working Group, which includes state attorneys general and banking regulators, was formed in early 2008 to work with servicers and federal regulators regarding foreclosure prevention efforts and related data collection. To see the Working Group's papers, including its January 2010 report, "Analysis of Mortgage Servicing Reports," please go to http://www.csbs.org/Content/NavigationMenu/Home/StForeclosureMain.htm.

A key failing of mortgage servicers has been the absence of sufficient staff to work with homeowners to restructure their loans in the wake of the bursting of the housing bubble. State regulators have strongly encouraged servicers to ramp up their loss mitigation activities to meet the current and anticipated need to assist homeowners. In addition, some states have enacted laws to regulate mortgage servicing companies, to reform the foreclosure process, to require servicers to engage in meaningful work-out negotiations, and to support local housing counselors in providing trusted and unbiased advice to homeowners struggling to stay in their homes.

The failing of mortgage servicers, coupled with the foreclosure crisis, have created the evolution of certain business roles in the industry to which the SAFE Act may apply. Outlined below are descriptions of three such categories and state regulators' comments regarding each category.

1. Loss Mitigation Employees of Mortgage Servicers

State regulators believe that requiring the licensure of loss mitigation employees of mortgage servicers in the near term would be counterproductive to the pressing and immediate need for servicers to increase staffing to meet loss mitigation needs.

As state regulators noted in our February 5, 2009 letter to HUD[7], we believe that if HUD determines that the SAFE Act requires loss mitigation employees of servicers to obtain a mortgage loan originator license, such licensure requirement should not be implemented until the current foreclosure crisis has ended. We continue to support this position today.

Based on current estimates of foreclosure trends, we encourage a delay of any licensure requirement on such individuals until through 2012. The Proposed Rule recommends such a delay -- but only for individuals providing or facilitating mortgage loan modifications and refinancing under the Department of the Treasury's Making Home Affordable Program. We believe that this time extension should not be limited to a specific program, but should cast as wide a net as possible to help facilitate all legitimate loss mitigation activities.

2. Employees of Third-Party Loan Modification Companies

As servicers have failed to effectively provide loan work-out opportunities sufficient to meet current demand, a new industry of third-party loan modification companies has emerged claiming to offer assistance to homeowners in working out their loans with their mortgage servicer. In addition, there are now "short sale negotiators," whose services might also warrant regulation. State regulators believe the emergence of these for-profit loan modification and short sale firms demonstrates the inadequate response of mortgage servicers to the ongoing foreclosure crisis.

Some states currently license loan modification companies and several states have statutes limiting the terms and conditions that such companies may offer. States have taken a strong role in enforcing state law against abusive or illegal loan modification companies, aggressively

[7] http://mortgage.nationwidelicensingsystem.org/SAFE/NMLS%20Document%20Library/csbs-aarmr-letter-to-hud-on-safe-act-2-5-09.pdf.

instituting enforcement actions in this area[8], and prohibiting certain business activities such as the charging of advance fees before any service is completed.

The Proposed Rule specifically notes HUD's view that third-party loan modification specialists should be covered by the licensing requirements of the SAFE Act. We agree with this view.

Loan modification companies are closely analogous to mortgage brokers in the origination market, as these companies actively solicit borrowers, market their ability to represent borrowers in the mortgage process and to directly negotiate with a borrower's lender, and seek compensation for services rendered. Because these companies directly solicit borrowers and compete in the marketplace for business, state regulators believe regulation and supervision of these companies and their employees, is needed to ensure that individuals have the background, knowledge, and experience to keep the promises they make in soliciting customers desiring loan modification assistance.

Thus to the extent such activities are legal under a particular state's laws, we believe individuals working for third party loan modification companies should be licensed as mortgage loan originators and regulated to the same degree as employees working for a mortgage broker or lender.

3. Non-profit Housing Counselors

Bona fide non-profit agencies, including HUD-approved counseling agencies, have responded to the foreclosure crisis by significantly increasing, and in some cases expanding, their counseling activities. State regulators do not believe that the activities of such organizations should automatically require non-profit housing counselors to be licensed as mortgage loan originators. Because of the numerous national, state and local homeownership preservation initiatives involved and the broad range of non-profit organizations providing housing counseling services, licensing determinations should be left to the states to determine on a case-by-case basis.

Bona fide non-profit housing counselors have provided critical support to struggling homeowners and are certified by the federal, state or local governments or national counseling organizations to perform these services. In most cases, these services are provided free of charge to the consumer and are funded through grants provided by government or other charitable sources. The income generated through these activities is typically unrelated to the outcome of the counseling. Moreover, bona fide non-profits have an express commitment to serve their communities and to act in the interests of their clients. In this sense, housing counselors are analogous to attorneys who are exempted from state licensing under the state SAFE Acts and HUD's Proposed Rules, if they act in the normal course of their profession, in that any mortgage loan originator activities are ancillary to their efforts to serve clients.

Counseling borrowers at risk of foreclosure and negotiating on their behalf has, by necessity, become one of the core functions of the non-profit counselors, and there are numerous federal,

[8] For example, see FTC press release dated July 15, 2009 describing joint state and federal agency enforcement efforts to crack down on mortgage modification scams (http://www.ftc.gov/opa/2009/07/loanlies.shtm).

state and local initiatives that depend on and support these efforts. Additionally, many states have adopted laws that require lenders to provide delinquent borrowers with referrals to local non-profit counselors prior to, or at commencement of, a foreclosure action, or that create foreclosure mediation programs that rely on non-profit counselors to assist borrowers negotiating with their lender. The federal government, through the Making Home Affordable Program and numerous federal agencies, including the FDIC, the FTC and HUD, expressly encourage borrowers at risk of default or foreclosure to consult HUD approved or other bona fide non-profit counseling agencies. Indeed, public efforts to combat loan modification and foreclosure rescue scams uniformly promote the availability of free non-profit counseling as the alternative for avoiding scams.

In order to support the continuance of these needed services by counseling providers, state regulators should be permitted to determine whether or not mortgage originator licensing requirements apply to a housing counselor. In making such a determination that such counseling activities do not warrant licensing, state regulators must apply standards such as verifying that the non-profit agency is a bona fide non-profit agency. However, state regulators recognize that non-profit status alone is insufficient to warrant exemption from licensing. Unfortunately, we have seen many firms established as "non-profits" for tax purposes but who clearly operate as profit seeking entities by charging upfront fees to clients and relying solely on revenues generated by fees charged to troubled borrowers. Employees of such non-profit entities who engage in loan origination activities should be licensed.

B. Individuals Employed by Bona Fide Non-Profit Organizations

State regulators have received numerous inquiries regarding the applicability of the SAFE Act to employees of bona fide non-profit organizations that originate residential mortgage loans or provide financial counseling and aid for low income borrowers and other individuals in financial distress. Sections B, C, and D of the preamble to the Proposed Rule describe the activities that trigger a loan originator licensing requirement and discuss what is meant by the term "compensation or gain." We agree with the statement in HUD's SAFE Act Q&As[9] that the non-profit status of an organization does not automatically result in exclusion of the organization's mortgage loan originators from licensing requirements. Furthermore, we believe that the SAFE Act, supplemented by commentary provided by HUD, provides state regulators with sufficient guidance and authority to make a case-by-case determination as to whether the activities of individuals working for particular non-profit organizations are covered by the definition of mortgage loan originator.

The HUD Commentary on the Model State Law affirms that "…there are some limited contexts where offering or negotiating residential mortgage loan terms would not make an individual a loan originator." The examples noted in the Commentary are triggered mainly by the lack of a formality and commercial context[10] in the mortgage-related activity which we believe exists in the operations of many bona fide non-profit housing organizations. Individuals working for non-

[9] http://www.hud.gov/offices/hsg/ramh/safe/safeactfaq.pdf.

[10] http://www.hud.gov/offices/hsg/ramh/safe/cmsl.cfm.

profits that operate in a commercial context should be subject to licensure. While state regulators recognize the potential for abuse of the non-profit status and do not endorse the adoption of a blanket exemption for all non-profit housing organizations, it is the experience of state regulators that there are certain models or programs of nonprofit housing organizations whose lending activities do not meet the commercial context contemplated by the SAFE Act and who are acting to fulfill a public purpose. Applying the SAFE Act to individuals working for such organizations may diminish the organization's capacity to counsel and assist homebuyers and homeowners who can benefit greatly from this assistance.

Many states currently exempt non-profit organizations that engage in some lending activities from their state licensing requirements provided that the organizations can demonstrate to the satisfaction of the state regulator that they are bona fide non-profits that operate in the public interest. In such situations, the state regulator reserves the authority to examine the organization's books and records as necessary and to revoke the exemption when appropriate.

The SAFE Act and HUD's commentary on the CSBS/AARMR Model State Law allow for discretion by state regulators. HUD's Final Rule should allow states the discretion to determine when individuals who work for bona fide non-profit community organizations that promote affordable housing and financing or that offer homeownership education and counseling or loss mitigation assistance do not meet the commercial context connotations of the compensation and gain requirement for licensure. Some of the factors to be considered in making a determination would include:

- the organization's funding sources;
- whether the organization has a tax exempt status as a charitable organization, such as under Section 501(c)(3) of the Internal Revenue Code;
- the loan terms and rates of mortgage loans originated or products offered, i.e. is the organization helping borrowers obtain credit at or below market rates or on terms more advantageous than are commercially available;
- whether the organization's primary purpose is to serve the public through helping low to moderate income borrowers or addressing other community credit and housing needs;
- the organization's compensation structure, i.e. whether there is a commission or other compensation structure that incentivizes the employees to steer consumers into certain types of loans or whether employees are compensated on a salary basis;
- whether the organization charges its clients fees in connection with the loan origination or other services and whether such fees are below standard commercial rates;
- whether the organization makes any profit on its loan products or services;
- whether financial literacy programs or homeownership education are provided in conjunction with the loan origination services; and
- whether the organization provides or requires training of their employees.

As noted above, such a determination should be made on an individual case-by-case basis and a determination made only after the state regulator reviews the non-profit organization's lending operations and structure.

C. Applicability of the SAFE Act to Employees of Governmental Entities

Because of many of the factors noted in the above discussion, state regulators believe that the SAFE Act requirements do not apply to federal, state, and local government employees who perform the activities of a mortgage loan originator as part of their official duties. We also think that the Act was not generally intended to include the activities of public housing finance agencies. Such individuals operate in a non-commercial context, and state regulators are aware of legal precedent that indicates that in common usage, the term "person" does not include the sovereign, and statutes employing the word are ordinarily construed to exclude it. This would apply to the SAFE Act's use of the word "individual" in section 1504(a).

D. Independent Contractor Loan Processors or Underwriters

The Proposed Rule provides clarity on what business activities performed by an individual encompass the activities of a loan processor or underwriter and therefore would require licensure. An individual engages in residential mortgage loan activities as a loan processor or underwriter if, with respect to a residential mortgage loan application, the individual performs clerical or support duties (as defined in the SAFE Act).

The determining factor in deciding whether an individual is performing simply "administrative or clerical" tasks or "clerical or support duties" hinges largely on whether the individual performs an analysis of the borrower's credit information or simply collects information from a borrower without making any attempt to analyze that information. The state regulators agree that such a distinction is appropriate. As noted in the preamble to the Proposed Rules, whether or not an individual is operating as a loan originator depends on function, not job titles, and it is the function that a particular individual engages in that the state regulator will review in making any such determinations.

In today's residential mortgage lending business, many companies outsource various aspects of the lending process, particularly with respect to those activities commonly referred to as processing and underwriting. Given this type of business model, often an individual who is a W-2 employee of a processing or underwriting company will perform loan processing or underwriting functions for a separate mortgage lending company that is not the individual's direct employer. Section E of the preamble to the Proposed Rules addresses this issue and attempts to set some guidelines.

State regulators have encountered numerous business model variations involving third-party companies that engage in contractual relationships with mortgage companies or other institutions to process or underwrite mortgage loans. One common example would be a situation where a third-party company contracts with mortgage providers to process or underwrite the provider's mortgage loans at its own premises utilizing its employee processors or underwriters, and maintains a mortgage company or mortgage broker corporate license. At least one licensed or registered loan originator would supervise and direct the processing or underwriting activities.

The Preamble suggests that the individual employees would not be required to obtain loan originator licenses if they perform clerical or support duties at the "direction of and subject to the supervision and instruction of a licensed or registered loan originator." However, because of concerns about the concept of sales staff supervising an institution's "gate keeping" staff, state regulators crafted the model state law to allow (and encourage) management or company supervision of the individual. The requirement that processors and underwriters be supervised by loan originators can create a potentially treacherous environment for consumers and subjects the institution itself to questionable practices. Regardless of the organizational structure, state regulators believe that consumers are better served by ensuring that all residential mortgage-related activities are subject to the regulator's supervision and that all such activities are covered by the appropriate bonding requirements.

It is impossible to anticipate or describe every business scenario in the marketplace. In determining whether a particular individual meets the "direction and supervision" requirements of SAFE, the regulator will analyze facts such as the direct lines of responsibility within the company, the internal processes and procedures regarding supervision of the employees, the actual duties being performed, and the business relationship – including the actual contract terms -- between the third-party company and the mortgage provider.

II. Section by Section Analysis of Proposed Rule

Subpart A -- General

§ 3400.23 Definitions

The Proposed HUD Rule, in § 3400.23, defines a number of terms affecting the applicability of the SAFE Act's licensing standards. In general, these definitions are consistent with HUD communications to date. State regulators offer the following comments reflecting our experience in licensing mortgage loan originators and our experience in promulgating rules to implement the SAFE Act over the past year.

Application

Clarification should be made that the word "and" as used in the definition of "application" is conjunctive; i.e. an application consists of the request for an offer of residential mortgage loan terms (in any form) and the information about a borrower that is customary or necessary in a decision on whether to make such an offer.

Employee

The term "employee" is referred to only once in the SAFE Act and the term is not defined in the Act. It is one of the determining factors as to whether or not an individual is eligible to be a registered mortgage loan originator. Under the SAFE Act, all individual loan originators must be either state-licensed or federally registered and the Act is clear what constitutes the distinction between the two. A "registered loan originator" is any individual who: (1) meets the definition of loan originator and is an *employee* of: (a) a depository institution; (b) a subsidiary that is owned and controlled by a depository institution and is regulated by a Federal banking agency; or (c) an institution regulated by the Farm Credit Administration; and (2) is registered with, and maintains a unique identifier through, the NMLS.

State regulators believe that the wording of this section and of the discussion in the preamble serve to clarify that this definition of employee is binding on the states only in the context of determining whether or not an individual must be a registered loan originator or a state-licensed loan originator. To ensure that the determination of who is eligible to be a registered loan originator reflects and accomplishes the purposes of the SAFE Act, we believe that those individuals must be true employees of the covered institutions. Loan originator registrants are not required to meet the education, testing, or surety bond requirements that apply to licensed loan originators because of the implied training, supervision, and resources of the institutions who claim them as employees and are responsible for their actions.

The definition of registered loan originator contained in the SAFE Act is meant to be interpreted very narrowly; i.e., the distinction between a licensing and registration requirement is entirely determined by what type of institution ***employs*** the loan originator. For an individual to be a "registered loan originator," the employer must be a depository institution (as defined in the SAFE Act), its owned and controlled subsidiary that is directly regulated by a federal banking agency, or an institution regulated by the Farm Credit Administration. Congress clearly intended to eliminate gaps in supervision that could result if individuals claimed to be "agents" of a federally-insured institution while not having a true employer/employee relationship that provides for substantive and comprehensive oversight of the individual by the institution.

We support the discussion of the meaning of "employee" that is included in the FDIC Draft Final Rule which utilizes the "right to control" test under the common law agency doctrine. "An employee is an agent whose principal controls or has the right to control the manner and means of the agent's performance of work." A federal banking agency-regulated institution will be expected to identify a loan originator as an individual subject to the rule if, following considerations of the relevant facts, the institution determines that the individual is an employee. The discussion further cites the IRS use of the common "right to control" test as its basis for classification of workers as employees. In the event the federal banking agencies add a specific definition of "employee" in the SAFE Act rules, the state regulators strongly urge that any such definition used to determine applicability of a mortgage loan originator registration be consistent with the HUD definition as revised by our suggestions.

In order to ensure the implementation of these principles, state regulators suggest that HUD's proposed definition for *employee* be revised to read as follows:

> *Employee*: (1) Subject to paragraph (2) of this section, means: (i) An individual:
> (A) Whose manner and means of performance of work are subject to the right of control of, or are controlled by, a person, and
> (B) Whose compensation for federal income tax purposes is reported, or required to be reported, on a W-2 form *issued by the controlling person*.
> (2) Has such binding definition as may be issued by the federal banking agencies in connection with their implementation of their responsibilities under the SAFE Act.

Loan Processor or Underwriter

The Proposed Rule's definition of "loan processor or underwriter" includes the phrase "with respect to the origination of a residential mortgage loan," which appears to exclude those individuals who review or analyze loan terms and origination practices after a loan is closed and funded. It is common in the residential mortgage lending business for companies to utilize the services of third-party consultant firms to provide due diligence compliance reviews to meet secondary mortgage market requirements. Such reviews are generally conducted on loans that have already been closed and funded and thus these individuals would not be conducting such activities "with respect to the origination of a residential mortgage loan."

The state regulators believe that such a distinction is reasonable and consistent with the intent of the SAFE Act. However, we propose that the phrase "with respect to the origination of a residential mortgage loan" be defined for purposes of this section to clarify that the origination process of a loan is not completed until the loan has been fully funded which often occurs after the formal "closing" of the loan. State regulators often receive consumer complaints regarding the non-funding of mortgage loans post-closing. Clarity surrounding the parameters of what is involved in the origination of a mortgage loan is needed to ensure that states retain the ability to provide protections to consumers obtaining a loan.

State regulators would suggest the following language be added to this section:

> "For purposes of this section, "origination of a residential mortgage loan" means all residential mortgage loan related activities from the taking of a mortgage loan application through the completion of all required loan closing documents and funding of the mortgage loan."

Subpart B – Determination of State Compliance with the SAFE Act

§ 3400.101 Scope of this Subpart

The language of Section 3400.101 makes it appear to be a foregone conclusion that HUD will determine that a state's licensing system does not meet the minimum standards. State regulators recommend that language in the paragraph be changed from "procedures that HUD follows to determine that a state does not have in place a system" to "procedures that HUD will follow to determine whether or not a state has in place an adequate system".

§ 3400.103 Individuals required to be licensed by States

Section 3400.103(c)(1) states that an individual takes an application for the purpose of "deciding" or "influencing the decision of another" regarding whether to extend a mortgage loan offer. "Taking of an application" is a determinant of whether the individual is a loan originator. The proper role of a loan originator does not include "deciding" whether to extend an offer of credit. Furthermore, a loan originator should not be permitted to influence an underwriter's decision. More appropriate wording would be that an individual takes an application, and is therefore determined to be a loan originator, if the individual "collects from the applicant or a person acting on behalf of the applicant information which will be used to determine whether or not to grant the applicant a mortgage loan."

§ 3400.105 Minimum Loan Originator License Requirements

<u>§ 3400.105(b)(2)(i)</u>: This subsection provides that an expungement of a [felony] conviction does not affect the ineligibility of the convicted individual. The term "expungement" is not defined in the Proposed Rule or the SAFE Act. As in the case of felony classifications, state laws define "expungement" differently. Including this subsection in the final rule could result in serious constitutional implications for rights of the individuals. State regulators believe this subsection should be deleted and that state law should be deferred to when determining the effect of expungement of a criminal conviction.

<u>§ 3400.105(d)</u>: Insert "mortgage" in the first sentence to correct the reference to the "Nationwide <u>Mortgage</u> Licensing System."

§ 3400.105(e)(2): The SAFE Act language is ambiguous regarding the number of times a candidate may take the test before beginning the six month cooling off period. One interpretation suggests three takings while another interpretation suggests four takings. In interpreting the language for the testing requirements, the Testing and Education Sub-committee of the CSBS/AARMR SAFE Implementation Work Group adopted the approach that is most beneficial to the loan originator; i.e., permitting an initial test taking followed by 3 opportunities to retake the test. Therefore, we would suggest that the language in (e) (2) be revised as follows:

> "(e) (2) …an individual may <u>retake</u> a test three consecutive times, with each retake…"

<u>§ 3400.105(e)(3)</u>: Although the language in Section 3400.105(e)(3) is taken directly from the SAFE Act, the language is confusing and contradictory in that it refers to a loan originator who is licensed by the state but who has failed to maintain his or her license. State regulators recommend changing the language from: "If a state licensed loan originator fails to maintain a valid license for 5 years or longer, the individual must retake the test and achieve a test score of not less than 75 percent correct answers" to:

> "If a formerly licensed loan originator is without a valid license for 5 years or longer, the individual must retake the test and achieve a test score of not less than 75 percent correct answers."

§ 3400.105 (h): The corresponding provision in the SAFE Act clarifies that the applicant must furnish "authorization for the NMLS to obtain" the administrative, civil, or criminal findings by any governmental jurisdiction and the independent credit report. The current language in the Proposed Rule authorizes an applicant to directly submit these items, rather than requiring the applicant to provide authorization for the NMLS to obtain the information.

We recommend the provision be rewritten as follows:

> "(h) Has submitted to the NMLS personal history and experience, including authorization for the System to obtain: …"

§ 3400.107 Minimum annual license renewal requirements

Section 3400.107(b) should be revised to reflect provisions contained in the CSBS/AARMR Model State Law that gives state regulators the authority to allow continuing education courses to be credited for the previous year when an applicant is renewing his or her license during an authorized license reinstatement period. For example, a loan originator does not renew his license prior to December 31, 2009, and had not completed the 8 hours of required continuing education for that year. The 8 hours are completed prior to the end of the license reinstatement period (generally, March 31, 2010) and, when submitted, are credited as completion of the continuing education requirement for 2009 and the individual's license is reinstated.

We recommend the provision be rewritten as follows:

> "(b) Except as otherwise allowed by applicable state rule or regulation regarding authorized license reinstatement periods, a State must provide that credit for a continuing education course is valid only for the year in which the course is taken."

§ 3400.109 Effective Date of State Requirements Imposed on Individuals

The state regulators suggest revisions concerning the provision in subsection (d) regarding a delayed effective date for implementation of SAFE Act licensing requirements for certain individuals engaged in loss mitigation efforts. Those suggestions are laid out on pages 3 to 5 of this letter in the section entitled, "Individuals Performing Loan Modifications."

§ 3400.111 Other Minimum Requirements for State Licensing Systems

Section 3400.111(f) provides that a supervisory authority require loan originators to ensure that originated loans are included in reports of condition submitted to the NMLS. The section states that the reports of condition "shall be in such form, shall contain such information, and shall be submitted with such frequency and by such dates as the NMLS may reasonably require."

In development of the functionality to allow submission of these reports through NMLS, the SAFE Implementation Working Group recommended that the reports of condition, or "call reports", be submitted at a company level, i.e., submitted by the companies that employ and supervise loan originators rather than by the loan officers themselves. State regulators have directed NMLS to develop a Mortgage Call Report to be completed at the company level. Alternative arrangements by state regulators will have to be considered for defunct companies which formerly employed loan originators and also for companies operating in states where the mortgage company is not subject to regulation. Also, in those states that permit the licensure of an individual loan originator without the requirement that the loan originator have a "sponsoring" company, it would be the responsibility of the loan originator (generally licensed as a sole proprietor) to submit the report.

NMLS is developing the Mortgage Call Report to be submitted by companies because the volume of call reports submitted by individual loan originators would be overwhelming, both to the mortgage loan originators, NMLS and the individual states which would have to process the information contained in the call reports.

Section 1505(e) of the SAFE Act does not specifically require "loan originators" to submit call reports but only specifies that "mortgage licensees" shall file the call reports. The Act does not define "mortgage licensees." Based on this language, state regulators believe it was the intent of the legislation to permit companies which employ loan originators to submit a consolidated report. State regulators believe the SAFE Act intended Mortgage Call Reports to be completed by companies due to the analogous nature to the Call Reports completed by federally-insured depositories to the FDIC. Individual loan originators would be required to provide information on loans originated to their employer companies so the companies could compile and submit the call reports.

State regulators ask that HUD recognize that call reports may be submitted to NMLS on a company level which represents the most efficient and comprehensive method of ensuring that the goal of obtaining information on all originated residential mortgage loans is met.

§ 3400.113 Performance Standards

§3400.113(a)(4): This section of the proposed regulations requires the supervisory authority to "examine and investigate loan originator licensees in a systemic manner based on identified risk factors or on a periodic schedule." State regulators note that many state supervisory authorities schedule examinations of, and prepare examination reports on, mortgage companies, i.e., the companies which employ the loan originators. State regulators believe this is not contrary to either the regulations or to the spirit and intent of the SAFE Act since any examination of the mortgage company must inherently include an examination of the loan originators which work for the company. By examining the company's individual loan files, the state supervisory authority is examining the loan originator's work and actions. Also, based on the findings of an examination, a state regulator may impose penalties on a company and/or any individual acting as a loan originator for that company. State regulators ask that HUD recognize that the origination and loan level components of state mortgage examinations are satisfactory examinations of the loan originators employed by the mortgage companies.

§ 3400.113(b): This section provides that a supervisory authority that is accredited under the Conference of State Bank Supervisors Mortgage Accreditation Program will be presumed by HUD to be compliant with required performance standards. We would like to applaud HUD for recognizing the quality and completeness of this program and would just note that the full title of the program is the CSBS-AARMR Mortgage Supervision Accreditation Program to reflect that the program is run jointly with AARMR. Accreditation by the program signifies that a state regulatory agency has demonstrated conformance with the nationwide standards of mortgage supervision and regulation set by the regulators.

§ 3400.115 Determination of Noncompliance

§ 3400.115(b): This section states that if HUD makes an initial determination that a state is not in compliance with the SAFE Act, HUD will notify the state and also publish its initial findings in the Federal Register. State regulators would like to have an opportunity to respond to any such notification from HUD prior to such publication. There may be statutes that appear to conflict with the SAFE Act, but due to the interpretation that a state has adopted in rule or in practice, there may well be no actual conflict. State regulators would appreciate the opportunity to ensure that there is, in fact, a noncompliant situation before the alleged finding is made public. The states believe that the final rule adopted by HUD should provide for an informal process to discuss concerns about non-compliance with a state prior to publishing an accusation of non-compliance in the Federal Register.

In addition, once HUD has formally alleged a state is not compliant with the SAFE Act and published that determination in the Federal Register, the rule should clearly identify the due process procedures available to the accused state for contesting the determination and, ultimately, appealing that determination to a court. The due process procedures should provide adequate notice of the determination by HUD and an opportunity for the state to be heard before a fair and neutral decision-maker with jurisdiction to hear the matter. The states would not oppose an administrative hearing process consistent with the Administrative Procedures Act with an appeal to an appropriate federal court.

Additionally, the state regulators request that when HUD makes a determination that a state is in compliance with the SAFE Act, that HUD provide the state a notice of compliance and publish the notice in the Federal Register.

State regulators would suggest that the section be rewritten as follows:

> (b) *Initial determination of compliance or noncompliance.* If HUD makes an initial determination that a State is in compliance with the SAFE Act, HUD will notify the State by letter and publish the initial finding in the Federal Register. If HUD makes an initial determination that a State is not in compliance with the SAFE Act, HUD will notify the State informally by letter and allow the State 30 days to respond by letter to HUD's determination. If HUD determines that the State is in compliance with the SAFE Act based on a State's response, HUD shall provide a letter to the State that confirms its compliance. If, based on the State's response, HUD believes the State is not in compliance with the SAFE Act, it may proceed with a formal determination through the procedure provided in subparagraph (c).

(c)(1) *Formal Accusation of Non-Compliance.* If HUD believes that a State is not in compliance with the SAFE Act after it has provided a State with an opportunity to comment pursuant to the informal letter procedure provided in subparagraph (b), HUD shall formally notify a State that it is not in compliance with the SAFE Act and publish such notice in the Federal Register. The formal notification shall provide the State with at least 30 days to respond. HUD shall allow~~, and presenting~~ the opportunity for public comment during the same 30 day period to allow the residents of the State and other interested members of the public to comment on HUD's initial determination.

(2) Due Process Proceedings. Any State accused by HUD of non-compliance with the SAFE Act through the formal process in subparagraph (c)(1) of this section shall be provided with administrative procedures to contest the determination of non-compliance and appeal such determination to an appropriate federal court. Such administrative procedures shall comply with the Due Process requirements of the United States Constitution and the Administrative Procedures Act. Any final decision by HUD shall be published in the Federal Register.

§ 3400.115(d): This section should be changed to enable state regulators to make a commitment to HUD to take whatever action is necessary to bring that state into compliance with the SAFE Act, with the understanding that a state may need to wait until the next legislative session, which may not occur annually, to effect the necessary changes. This subsection should be revised as follows:

"(d) *Good-faith effort to meet compliance.* If HUD makes the final determination described in paragraph (c) of this section, but HUD finds that the State is making or has committed to make a good-faith effort to meet the requirements of 12 U.S.C. 5104, 5105, 5107(d), and this subpart, HUD may grant the State a period of not more than 24 months to comply with these requirements."

Additionally, the state regulators believe that if a state does make a good faith effort to bring its statutes and rules into compliance with the SAFE Act, there should be a formal process for HUD to notify the state as to the sufficiency of those efforts. If a state does not succeed in bringing its statutes into compliance with the SAFE Act, there should be a mechanism in place to allow a later time period to reach compliance. HUD should utilize the same process that was used to make the initial determination of compliance or noncompliance to review the good faith effort of the state to bring their statutes into compliance with the SAFE Act.

Therefore, we would suggest the addition of the following provision in § 3400.115:

"Review of state effort to comply with requirements. In reviewing the good faith effort of the state to meet compliance, HUD shall follow the procedure set forth in subparts (b), (c), and (d) above."

Section 3400.115 should also include a formal process for states to follow after receiving a final determination of noncompliance. We would suggest the following new subsection be added to § 3400.115:

> *Request after final determination of noncompliance.* A State that has received a final determination of noncompliance as outlined in paragraph (d) of this section, may submit a request for a new determination concerning compliance with the SAFE Act. A State requesting a new determination must provide evidence that it is in compliance with the requirements of the SAFE Act, and that it has specifically addressed all deficiencies noted in the final determination of noncompliance. Additionally, if the State had documented performance deficiencies that contributed to the final determination, HUD shall consider any steps the State has taken to correct performance deficiencies and to prevent them from recurring in making its determination. If HUD determines that the State has corrected its deficiencies and is in compliance with the SAFE Act, it shall publish such determination in the Federal Register and shall discontinue licensing of mortgage loan originators in that State.

Technical Comments to §3400.115: State regulators would like to note the following technical drafting comments regarding references to the SAFE Mortgage Licensing Act of 2008 and of the regulations themselves.

1. Proposed §§3400.115(d) and (e)(2)(ii) reference 12 U.S.C. 5107(d). There is no 12 U.S.C. 1507(d).
2. Proposed §3400.115(e)(2)(i) refers to "The expiration of the period of time granted pursuant to paragraph (c) of this section". State regulators believe the section should refer to "paragraph (d)" rather than "paragraph (c)".

§ 3400.305 Data Security

§ 3400.305(b): This section places security breach notification requirements on NMLS in the event that NMLS has a reasonable belief that a security breach has occurred. Licensee information contained in the system is owned by the state agencies that license mortgage loan originators, and under the terms of the State Agency User Agreement, all applicant data owned by state agencies will be treated by the agency in accordance with its respective state privacy and public information laws. Under the terms and conditions of use/privacy policy, the State Regulatory Registry's obligation is to notify the state agencies of any data breach and work with the state agencies regarding state and federal requirements for licensee notification and rights and obligations of the affected licensees. State laws differ in what rises to the level of a breach requiring notification.

We suggest that the section be rewritten as follows:

> "In the event that NMLS becomes aware of a security breach which NMLS believes has resulted or may result in the unauthorized access, use or disclosure of nonpublic personal information of End Users, NMLS will promptly investigate the matter and notify the applicable States of such breach. The States will be responsible for notifying their affected End Users and any other parties in accordance with applicable law."

*   *   *

The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators appreciate the work that HUD has done in carefully drafting the Proposed Rule and look forward to continuing to work with HUD to implement the SAFE Act in order to enhance mortgage supervision and protect consumers.

Sincerely,

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