Oregon
John A. Kitzhaber, MD, Governor

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April 25, 2013

Chair Chip Shields
Vice-Chair Larry George
Senate Committee on General Government, Consumer & Small Business Protection
Oregon Legislative Assembly

Re: Follow-up Information on House Bill 2856-A

Dear Chair Shields and Vice-Chair George:

This letter is the requested follow-up to testimony the committee received in the public hearing for House Bill 2856-A on Wednesday, April 23. At the public hearing, Mr. Jim Templin, a licensed escrow agent, offered his perspective on whether a person should be able to match up borrowers with lenders to facilitate private money lending and we were asked to provide follow up comments on his position. If we understood Mr. Templin's concern, he was worried about having to obtain a mortgage loan originator (MLO) license to introduce or match buyers and sellers in a seller-financed transaction.

Under Oregon's implementation of the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act), a person that either (1) takes an application for a residential mortgage loan, or (2) negotiates or offers to negotiate the residential mortgage loan is an MLO and needs to be licensed. A person that merely introduces borrowers and lenders should not need to obtain a mortgage loan originator license for that activity. To meet the exemption, the person cannot receive the kinds of information that would be needed for a loan application (such as Social Security numbers, borrower income or estimates of property value) or provide or develop loan terms.

Under current law, the lender that the facilitator introduces to the borrower likely needs a mortgage loan originator license, unless the nature of the transaction exempts the lender (for example, if the lender sells her own home, or negotiates the sale of a relative's home). Passage of HB 2856-A as written would allow home owners to finance up to 3 transactions in a 12 month period, up to a cap of eight such outstanding loans without a license. For non-exempt transactions, a lender does not need to become licensed if the lender elects to negotiate the loan terms through an MLO.

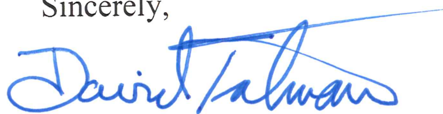
For some background, the Congress passed the S.A.F.E. Act in order to reduce mortgage fraud and ensure that borrowers understood the terms of the residential mortgage loan. Passed in

response to the mortgage crisis, the S.A.F.E. Act requires all states to license loan originators. Licensed originators are educated on state and federal fair lending laws, so that the real estate buying public has assurances that their originators will provide the proper disclosures and follow the proper procedures. If any state fails to comply with the minimum requirements of the S.A.F.E. Act, the federal government has the option of taking over mortgage loan originator licensing in that state.[i]

The federal Consumer Financial Protection Bureau (CFPB) recently implemented rules to supplement the MLO requirements of the S.A.F.E. Act. The requirements level the playing field by making sure that the lender is loaning money to someone who has the ability to and intends to repay the loan, and that the borrower has all of the necessary information to make an informed decision before entering into the loan agreement with a lender. Further, the MLO is required to be knowledgeable about the requirements of the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) and ensure compliance with these laws.

The S.A.F.E. Act ensures that a borrower receives critical loan information that will allow the borrower to make an informed borrowing decision and the licensing and disclosure requirements increase the likelihood that a lender is making a loan to someone who is able to repay it and reduce the risks that can occur in the event of a default.

Sincerely,



David C. Tatman
Administrator, Division of Finance and Corporate Securities

cc: Members of the Senate Committee on General Government, Consumer & Small Business Protection

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[i] I have enclosed a copy of a recent guidance from the National Association of Realtors interpreting the CFPB's recent rulemaking concerning MLOs. It demonstrates how Congress and the CFPB have zealously limited exemptions to the definition of MLOs. I believe that states have to recognize the restrictive perspective of the federal government when contemplating changes to the MLO laws.

# Impact of Loan Originator Final Rule on Seller Financing

(February 8, 2013)

The new final rule establishing Loan Originator Compensation Requirements[1] applies broadly to loan originators, including seller financers that do not qualify for an exclusion from the definition. The Consumer Financial Protection Bureau (CFPB) released the rule on January 20, 2013, as part of its implementation of amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted on July 21, 2010. The rule takes effect on January 10, 2014, except for two provisions related to loan originator qualifications that take effect on June 1, 2013.

The definition of loan originator is broad. It covers anyone who, for compensation, performs any activities related to the origination of mortgage loans, including (but not limited to): taking an application or offering, arranging, or assisting a consumer in obtaining or applying for credit.

TILA, as amended, and CFPB's implementing regulations exclude from the definition of loan originator some sellers who provide seller financing. Because the requirements are extremely complex, unless seller financers qualify for exclusion, they will as a practical matter have to use another approach for financing the sale of the property, including engaging a licensed loan originator without performing loan origination activities themselves. This is similar to the situation under the SAFE Act's loan originator licensing requirements where, unless you are exempt from licensing under the state law enacted to implement the SAFE Act, it is not usually practicable to provide seller financing directly.

In response to NAR and many other commenters, CFPB has provided some flexibility in the new final rule by excluding from the definition of loan originator two categories of seller financing: those that sell 3 or fewer properties in any 12-month period and those that sell only one in any 12-month period, and in both cases meet other criteria. If you sell one property using the less restrictive exclusion rules and then seek to sell a second property, the safest course would be to wait for the expiration of 12 months after consummation of the first sale before selling the second property. Though the CFPB made minor changes to the statute, such as the one property exclusion noted above and not requiring proof of documentation of a borrower's ability to repay, the Bureau determined to not eliminate the criteria in the seller financing exclusion as defined in the Dodd-Frank Act.

**<u>Seller Financers—3-Property Exclusion</u>**

This exclusion applies to "persons" as defined broadly under TILA to include not only "natural" persons but also a wide range of organizations such as corporations, partnerships, proprietorships, estates, and trusts. To be excluded from the definition of loan originator using the 3-property exclusion, you must meet all of the following criteria:

i. The person provides financing for the sale of 3 or fewer properties in any 12-month period. Each property must be owned by the seller and serve as security for the financing.

ii. The person has not constructed, or acted as construction contractor for, a residence on the property in the ordinary course of business of the person.

iii. The person provides seller financing that meets the following requirements:

   A. The financing is fully amortizing (no balloon mortgages or negative amortization).

[1] See 12 CFR section 1026.36.

B. The person determines in good faith that the consumer (buyer) has a reasonable ability to repay. The regulation does not require documentation of the determination, which significantly eases the regulatory burden, though CFPB points out it may be a good idea in the case questions arise whether the seller made the determination. CFPB's Official Interpretations of the regulation provide guidance on how a seller could make the determination that the buyer has a reasonable ability to repay. This could include considering earnings as evidenced by payroll or earning statements, W-2s, etc.; other income from a federal, state, or local agency providing benefits and entitlements; and/or income earned from assets (such as financial assets or rental property). The value of the dwelling may not be considered as evidence of the buyer's ability to repay. The seller may rely on copies of tax returns.

C. The financing has a fixed interest rate or an adjustable interest rate that is adjustable after 5 or more years. If it has an adjustable rate, it must have reasonable annual and lifetime limits on rate increases and provide for the rate to be determined by the addition of a margin to an index rate based on a widely available index such as indices for U.S. Treasury securities or LIBOR. CFPB's Official Interpretations note that an annual rate increase of up to 2 percentage points is reasonable. A lifetime cap of 6 percentage points, subject to a minimum floor and maximum ceiling up to any applicable usury limit, is reasonable. These "safe harbors" are not mandatory, but sellers would be wise to adopt them.

Note: If you are considered a creditor under TILA because you make 2 or 3 high cost loans under the Homeownership and Equity Protection Act (HOEPA), you are considered to be a loan originator for purposes of the loan originator qualification requirements in 12 CFR section 1026.36(f) and (g) and any other rules applicable to creditors under TILA. This is true even if you are exempt from the definition of loan originator under the 3-property exclusion. Check with an expert to make sure you avoid providing seller financing subject to HOEPA, which imposes many more limits and requirements.

**Seller Financing—1-Property Exclusion**

This more flexible exception applies only to a more narrow definition of "persons" (only natural persons, estates, and trusts) that sell only 1 property in a 12-month period. The exclusion is not available to other organizations, such as corporations, partnerships, or proprietorships. To be exempt from the definition of loan originator using the 1-property exclusion, you must meet the following criteria:

i. The person provides financing for the sale of only one property in any 12-month period. The property must be owned by the seller and serve as security for the financing.

ii. The person has not constructed, or acted as construction contractor for, a residence on the property in the ordinary course of business of the person. (This is the same requirement as applies for the 3-property exclusion.)

iii. The person provides seller financing that meets the following requirements:

A. The financing has a repayment schedule that does not result in negative amortization. A balloon mortgage is permitted. (NAR sought relief from the prohibition against balloon mortgages.)

B. The financing has a fixed interest rate or an adjustable interest rate. If it has an adjustable rate, it must have reasonable annual and lifetime limits on rate increases and provide for the rate to be determined by the addition of a margin to an index rate based on a widely available index such as indices for US. Treasury securities or LIBOR. CFPB's Official Interpretations note that

an annual rate increase of up to 2 percentage points is reasonable. A lifetime cap of 6 percentage points, subject to a minimum floor and maximum ceiling up to any applicable usury limit, is reasonable. (This is the same requirement as applies for the 3-property exclusion.)

**Other Requirements Apply Even if You Are Not a Loan Originator**

Even if you are excluded from the definition of loan originator, you are only exempt from the loan originator requirements of the regulation. An exempt person would still be subject to the rule prohibiting anyone from paying a loan originator compensation based on the terms of the transaction (e.g., higher payments for loans with higher interest rates). This would occur if a seller financer engages a loan originator to assist with setting up the financing for the seller financing. In addition, the limits on mandatory arbitration would also apply. The contract or other agreement for any credit transaction, including any seller financing, may not require arbitration or other non-judicial procedures to resolve disputes. After a dispute arises, however, the parties may agree to use arbitration or other non-judicial procedure.

## Exclusion of Real Estate Activities from Loan Originator Compensation Rule

The new final rule establishing Loan Originator Compensation Requirements[2] applies broadly to loan originators, excluding licensed persons engaged solely in real estate brokerage activities. The Consumer Financial Protection Bureau (CFPB) released the rule on January 20, 2013, as part of its implementation of amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted on July 21, 2010. The rule takes effect on January 10, 2014

The definition of loan originator is broad and imposes many requirements on anyone covered by the rule. The definition includes anyone who, for compensation, performs any activities related to the origination of mortgage loans, including: taking an application; assisting a consumer in obtaining or applying to obtain a loan; offering or negotiating terms of a loan; or advertising any of these services. The real estate activities exclusion applies to licensed persons performing only real estate brokerage activities, unless compensated by a creditor or loan originator for a particular consumer credit transaction covered by the rule. Providing clients with uncompensated general information about mortgages or lists of reputable lenders does not appear to bring a broker/agent under the definition of loan originator.

The CFPB has provided guidance clarifying that compensation paid by a creditor or loan originator to a real estate broker/agent does not transform a real estate brokerage activity into a loan originator activity. The CFPB explains:

- A person paid solely for real estate brokerage activities by a loan originator or creditor is not covered by the definition of loan originator.
- When a real estate broker/agent sells a property owned by a creditor (such as an REO), the commission does not turn the real estate brokerage activity into a loan originator activity.

But care is needed. CFPB also notes:

- Even if State law provides that loan origination activities are eligible real estate brokerage activities, the real estate broker/agent is nevertheless considered to be a loan originator under the final rule if engaged in loan originator activities as defined under the final rule.
- A broker/agent is a loan originator when paid for performing creditor, mortgage broker, or consumer credit referral activities.
- If a broker affiliated with a creditor pays an agent for origination activities, such as for taking the consumer's credit application and performing other functions related to origination of the loan, the agent is a loan originator.

[2] See 12 CFR section 1026.36.