

Recent Developments in State Licensing for Holders of MSRs

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Recently, Oregon and Pennsylvania enacted laws, regulations and/or regulatory guidance regarding mortgage servicer licensing that have potential implications for nonbank mortgage servicing rights holders. The author of this article discusses these developments.

As the demand for mortgage servicing rights (“MSRs”) increases among investors, many states continue to focus on the licensing of MSR holders, even when the day-to-day servicing of the loans is performed by a licensed subservicer. Recently, Oregon and Pennsylvania enacted laws, regulations and/or regulatory guidance regarding mortgage servicer licensing that have potential implications for nonbank MSR holders, and which are discussed in more detail below.

Other recent notable state activity in this area includes a December 2017 enforcement action by the Arkansas Securities Department against an MSR holder on the grounds that it was acting as an unlicensed mortgage servicer, and the imposition of a \$5,000 fine. In December 2016, the Kentucky Department of Financial Institutions issued a memorandum stating its position that MSR owners must be licensed.

An Overview of MSR Licensing Requirements

Determining whether a state requires licensing for MSR holders can be a complex process due to varying state laws and differing interpretations of state regulators on this issue. To this end, most state licensing laws do not specifically provide that MSR holders must be licensed, but regulators may reach this conclusion due to a broad interpretation of the statutory language. Note that this discussion focuses on the licensing implications of owning MSRs as opposed to investing in excess servicing fees (i.e., an interest in the servicing fee income that exceeds a base servicing amount necessary for the owner of the servicing to service the loan). To the extent that investors in excess servicing fees do not actually own MSRs or engage in servicing activities, they generally should not be considered “servicers” for purposes of state licensing requirements.

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For example, some states require a license to “directly or indirectly” engage in mortgage servicing activities. In these states, regulators often take the position that an entity that owns MSRs is “indirectly” engaging in mortgage servicing, and therefore, unless otherwise exempt, must be licensed. States may also take the position that, absent an applicable exemption, MSR holders must be licensed when the definition of “servicer” includes not only a person that receives, but also a person that has the right to receive, certain types of payments on a mortgage loan.

Depending on the state, some additional factors that may be relevant to the analysis include whether the entity that holds the MSR also originated the loan, and whether the entity owns only the MSR (with the underlying loan being held by a third party) or owns the whole loan.

Recent Developments in Oregon

On April 17, 2018, Oregon’s final rules related to mortgage servicer licensing became effective. These final rules, adopted by the Oregon Department of Consumer and Business Services, Finance and Securities Regulation, implement Senate Bill 98, which was passed in the 2017 legislative session and became effective January 1, 2018, and requires the licensing of nonbank mortgage servicers. Oregon had previously implemented interim regulations to implement these requirements.

Under the new law, a license is required to “directly or indirectly” service a residential mortgage loan. “Service a residential mortgage loan” means to: (a) receive a scheduled periodic payment from a borrower under the

terms of a residential mortgage loan, including any amounts for deposit into an escrow account the lender establishes in accordance with the Real Estate Settlement Procedures Act; (b) pay to the lender or another person principal, interest and other amounts associated with a residential mortgage loan in accordance with the terms of any contract or agreement for servicing the residential mortgage loan; or (c) pay an amount to a borrower, if the residential mortgage loan is a home equity conversion mortgage or a reverse mortgage. Under the final rules, a licensing exemption is available for a person that “owns the rights to service a mortgage loan but does not otherwise service a residential mortgage loan [as defined above], including having an ongoing contractual obligation to provide financial support to a subservicer.” In other words, an MSR owner will be exempt from licensing as long as it does not engage in the servicing activities outlined above (receiving scheduled payments, making principal and interest payments to a lender or another person or, for reverse mortgages, making borrower advances), even if it is required to provide ongoing financial support to a subservicer (i.e., reimburse the subservicer for escrow advances). Based on informal discussions with the department, we understand MSR owners may need to be licensed in certain circumstances, such as when the MSR owner directly makes escrow advances or where a subservicer services the loans in the MSR owner’s name (i.e., private label servicing).

In addition to the regulatory exemption described above, Oregon law provides an exemption for a person that services 5,000 or fewer loans, not including loans they or an affiliate originates or owns. The new regulation

provides some parameters and guidelines for how this exemption is applied. For example, a person qualifies for the exemption for a particular calendar year if it, along with all affiliates in all operations within the United States, serviced fewer than 5,000 residential mortgage loans in the 12-month period preceding September 30th of the prior year.

Recent Developments in Pennsylvania

The Pennsylvania Department of Banking recently issued an FAQ on its website confirming that its new mortgage servicer licensing requirement applies to MSR holders.

This guidance comes on the heels of Pennsylvania Senate Bill 751 (known as Act 81), enacted in December 2017, which amended the state's existing Mortgage Licensing Act to require the licensing of nonbank mortgage servicers. Pennsylvania requires a license to engage in the mortgage loan business, which now includes servicing mortgage loans. Under the new law, a "mortgage servicer" is someone who "engages in the mortgage loan business by directly or indirectly servicing a mortgage loan." "Service mortgage loan" means collecting or remitting payment or the right to collect or remit payments of principal,

interest, tax, insurance or other payment under a mortgage loan. Previously, "service mortgage loan" only included collecting or remitting such payments, or having the right to collect or remit such payments, for another.

In March 2018, the department issued an FAQ on its website confirming that both the owner of master servicing rights and any subservicer that performs the servicing duties for such loans would need to obtain mortgage servicer licenses. A separate FAQ clarifies that a company that owns a loan but does not service it, either as a master servicer or subservicer, is not required to be licensed as a mortgage servicer. However, a company that originated and negotiated a mortgage loan, but sold the loan and retained servicing rights (either as a master servicer or subservicer), is required to be licensed as a mortgage servicer.

Takeaways

Investors in MSRs should continue to monitor developments in servicer licensing, including new laws, regulations and interpretive guidance from regulators, as an increasing number of states are requiring licensing for MSR holders.