

October 21, 2003

Re: Licensee Outsourcing of Certain Mortgage Processing Functions

Dear _____ :

This letter responds to your request for a determination by the Pennsylvania Department of Banking (the "Department") of whether your client, [redacted] (the "Lender"), a lender licensee under both the Mortgage Bankers and Brokers and Consumer Equity Protection Act ("MBBCEPA"), 63 P.S. § 456.101 *et seq.*, and the Secondary Mortgage Loan Act ("SMLA"), 7 P.S. § 6601 *et seq.*, may contract with a company, which you indicate will also be a lender licensee under the MBBCEPA and SMLA (the "Company"), to have the Company perform certain back-office mortgage processing functions for the Lender.

Factual Background

You have indicated the following factual background, which is essentially quoted directly from your letter.

The Lender currently originates non-prime mortgage loans for borrowers nationwide and would like to contract with the Company to process prime loans that the Lender would offer to qualified applicants. The Lender would require the Company to follow Federal National Mortgage Association and/or Federal Home Loan Mortgage Corporation underwriting guidelines and additional guidelines that the Lender specifies, including instructions and limitations regarding loan documentation and loan processing, as well as loan rates and fees (collectively, the "Guidelines"). All loan documentation that would be provided to prime loan applicants would be in the Lender's name and would be reviewed and approved by the Lender prior to commencement of the program. Once the Lender approves the documentation, the Company would generate all documents with the appropriate borrower-specific information and provide the same to prime loan applicants in accordance with the Guidelines.

Prime loan applications would be processed as follows: Through the Lender's retail channel, employees of the Lender would contact a potential applicant, identify themselves as employees of the Lender (the "Lender Employees"), and solicit interest in the prospect for a loan product offered by the Lender. At any stage in the process when the Lender Employee believes that the particular loan applicant may qualify for a prime loan, further loan processing would be transferred to the Company for handling.

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Once a consumer telephone call is transferred to the Company, a loan officer employed by the Company would continue to process the transaction. The Company loan officer (the "Company Employee") would answer the phone in the name of the Lender. The Company Employee would present the prime loan programs available, complete the remaining data elements, sign the application form as agent for the Lender and, if appropriate, obtain the applicant's credit report. Based upon a preliminary underwriting analysis that indicates that a particular applicant qualifies for a prime loan, the Company Employee would notify the Lender that the applicant has conditionally met the Guidelines for a prime loan. The Lender will then enter the information into its system noting that the loan is conditionally approved for further processing. Any applications that are not conditionally approved as qualifying for a prime loan would be considered by the Lender for a non-prime loan. In all events, notification of denied loans would be sent either by the Company or the Lender using forms pre-approved by the Lender.

Following the initial determination that a particular loan is conditionally approved as a prime loan, the Company Employee, following the Guidelines, would continue processing the mortgage loan. For example, the Company Employee would verify employment and other required information as well as obtain appraisals. If it appears that the loan applicant has fully met all requirements for a prime loan under the Guidelines, the Company Employee would send a final loan report to the Lender notifying the Lender that the loan meets all such requirements. The Lender would then enter information regarding the loan application into its system and note the loan as approved for funding by the Lender.

The Company Employee would then prepare the necessary mortgage loan documentation and forward the documentation to the closing agent. The prime loan would be closed in the Lender's name and funded by the Lender. Funds would be sent directly from the Lender to the closing agent. The Lender then, at its option, may sell the prime loan in the secondary mortgage market, and the Company may be an investor in such sales.

In accordance with the Guidelines, all necessary federal and state disclosures that are required for a prime mortgage loan to be originated by the Lender, under the Lender's license, would be provided to an applicant by the Company or the Lender, as appropriate. The Guidelines provided by the Lender to the Company would have previously advised the Company of the appropriate fees, disclosures, and other requirements imposed by Pennsylvania law.

If the loan is approved by the Lender, the mortgage loan documentation, such as the note and the mortgage, would be retained by the Company in anticipation of a prompt sale into the secondary mortgage market. The Lender, however, would have the ability to obtain the files expeditiously if needed for examination by the Department. As applicable, the Lender would comply with any requirements regarding storage of files off-site or out-of-state.

Any Company Employee that will be discussing or negotiating or otherwise interfacing with a proposed prime loan applicant will be licensed or registered under the Company's name to the extent required. The Company will also have expertise in originating prime mortgage loans for its own account. The Company would operate loan processing centers in various states, all of which would be licensed as branch offices of the Company. The Lender would not license these loan processing centers as branch offices of the Lender.

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All of the foregoing back-office processing functions would be reflected in appropriate contract documents between the Lender and the Company utilizing terms and conditions for “outsourcing” contracts that are typical in the mortgage industry.

Legal Analysis

The MBBCEPA provides that a person is deemed to be engaged in the “first mortgage loan business” in Pennsylvania if:

. . . that person advertises, causes to be advertised, solicits, negotiates or arranges in the ordinary course of business, offers to make or makes more than two first mortgage loans in a calendar year in this Commonwealth, whether directly or by any person acting for his benefit.

63 P.S. § 456.302.

The SMLA provides that a person is deemed to be engaged in the “secondary mortgage loan business” in Pennsylvania if:

(i) such person advertises, causes to be advertised, solicits, negotiates or arranges in the ordinary course of business, offers to make or makes more than two secondary mortgage loans in a calendar year in this Commonwealth, whether directly or by any person acting for his benefit, but this provision shall not prohibit advertising or solicitation by a licensee under a general corporate name, logo or trade mark; or

(ii) such person in the ordinary course of business becomes the subsequent holder of more than two promissory notes or mortgages, indentures or any other similar instruments or documents received in a calendar year in connection with a secondary mortgage loan; provided, however, that a person will not be deemed to be engaged in the secondary mortgage loan business if such person becomes the subsequent holder of two or more promissory notes or mortgages, indentures or any other similar instruments or documents received in a calendar year in connection with a secondary mortgage loan solely as an investment and such person is not otherwise in the business of making or servicing such loans.

7 P.S. § 6603(a)(5).

The MBBCEPA and the SMLA do not explicitly address whether a licensee, such as the Lender, may outsource mortgage processing functions. However, the Department has consistently taken the position that licensees under both the MBBCEPA and SMLA may outsource back-office mortgage processing functions, such as reviewing loan packages and applying lending program criteria, to another entity and that such other entity may conduct such processing functions without a license under the MBBCEPA and SMLA, provided that such processing functions do not involve interaction with consumers.

The processing functions that the Company will conduct for the Lender as described in your letter would exceed the types of back-office functions that do not require licensure because the Company would be

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negotiating with consumers, which would rise to the level of engaging in the first and secondary mortgage loan businesses as contemplated by the MBBCEPA and SMLA, respectively. As you indicate in your letter, however, the Company will be licensed as a lender under both the MBBCEPA and SMLA. Therefore, it is the Department's position that the Lender may outsource the mortgage processing functions described in your letter to the Company and that such mortgage processing functions performed by the Company for the Lender would be permissible for the Company as a licensee under both the MBBCEPA and SMLA.

While you do not specifically request guidance regarding the subsequent sale of loans that are processed in this manner, the Department notes that there are restrictions concerning licensees' sales of secondary mortgage loans under Section 11 of the SMLA.¹

This letter addresses only the legal permissibility of the outsourcing activity under the MBBCEPA and SMLA as described in your letter and does not approve or endorse the Lender's proposed business plan as described in your letter.

The Department's analysis is based upon the facts as stated in this letter. Any change in the facts could result in an amendment or reversal of the Department's position. This letter has been authorized by the appropriate Department personnel and constitutes a duly authorized statement of the Department's position regarding the issues discussed herein. This letter may not be relied upon or construed as constituting legal advice.

Please do not hesitate to contact me if you have any further questions regarding this matter.

Sincerely,

Carter D. Frantz
Staff Counsel

cc: Cynthia G. Wirt
Director, Bureau of Licensing, Compliance and Consumer Services

Victor H. Seesholtz
Manager, Compliance Division

¹ Section 11 of the SMLA provides that:

[a] secondary mortgage loan licensee and a secondary mortgage loan broker licensee shall not:

* * *

(3) [u]nless the licensee shall retain responsibility for servicing the loan assign, sell or transfer a secondary mortgage loan to any person except a licensee or a person excepted from the licensing provisions of this act in accordance with section 3 hereof without written permission of the secretary.

7 P.S. § 6611(3). The MBBCEPA does not similarly restrict the sale of first mortgage loans originated under the MBBCEPA.