

June 1, 2005

Re: Licensing Requirements Applicable to Secondary Market Investment in Partially-Drawn Home Equity Lines of Credit

Dear _____ :

This is in response to your letter to the Department of Banking (the "Department") in which you request the Department's position regarding the applicability of Mortgage Bankers and Brokers and Consumer Equity Protection Act ("MBBCEPA"), 63 P.S. § 456.101 *et seq.*, the Secondary Mortgage Loan Act ("SMLA"), 7 P.S. § 6601 *et seq.*, or any other similar statute under the Department's jurisdiction to your client's (the "Investor") investment in partially-drawn home equity lines of credit ("HELOCs").

Factual Background

You indicate in your letter the following factual background, which is essentially quoted directly from your letter.

For the purposes of this letter, the Department is to make the following assumptions: (i) the Investor is a Delaware corporation with its principal place of business in New York; (ii) the Investor proposes to invest in both first and subordinate lien HELOCs secured by residential property located in Pennsylvania; (iii) the Investor does not service any of the HELOCs that it acquires and ensures that servicing functions are performed by an appropriately licensed third-party servicer (the "Servicer"); (iv) any funds that the borrower requests would be advanced according to the terms of the credit agreement entered into between the originator of the HELOC (the "Lender") and the borrower, which agreement would not be altered in any way by the Investor or any other party;¹ and (v) the Investor does not

¹ The Department notes that in several of the factual scenarios described in this letter, the Investor is required to provide funds to the Lender or Servicer in order for the Lender or Servicer to make advances on the HELOC. The Department assumes that, based upon assumption (iv), adequate measures will be taken to ensure that the Lender and Servicer will always have funds available for HELOC advances upon request of a borrower.

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maintain an office or have any employees in Pennsylvania.

A. Servicing-Retained Purchase and Sale

In the first scenario, the Investor purchases and sells the HELOCs on the secondary market. In other words, the Lender uses its own funds to originate the HELOCs in its own name and subsequently sells the loans to the Investor at market value. This scenario does not involve “table-funding,” whereby the Investor would advance funds to the settlement lender at closing and the settlement lender would contemporaneously assign the HELOCs to the Investor.

Significantly, under the purchase agreement between the Lender and the Investor, the Lender retains the obligation to service the HELOCs and to make additional advances under the original, pre-existing terms of the HELOC. However, the Investor is obligated pursuant to the terms of an agreement between the Lender and the Investor to either: (i) provide any funds to the Lender in order for the Lender to make an advance; or (ii) reimburse the Lender for the amount of any advance that is not recoverable from the general proceeds of the HELOCs.

B. Servicing-Released Purchase and Sale

As under the first scenario, the Investor purchases and sells the HELOCs on the secondary market. However, the Investor acquires the HELOCs from the Lender on a “servicing-released” basis and subsequently assigns or sells the HELOC servicing rights to the Servicer. The Investor and Servicer enter into a servicing agreement under which the Investor is required to either: (i) provide any funds to the Servicer in order for the Servicer to make an advance; or (ii) reimburse the Servicer for the amount of any advance that is not recoverable from the general proceeds of the HELOCs.

C. Servicing-Released Three-Way Purchase and Sale

Under the third scenario, the Investor, Servicer, and Lender enter into a three-way purchase and sale agreement. The terms of this agreement require the Lender to sell the HELOCs to the Servicer on a servicing-released basis and the Servicer to simultaneously sell the HELOCs to the Investor. The Servicer retains the servicing rights for its own account. The Investor is required to either: (i) provide any funds to the Servicer in order for the Servicer to make an advance; or (ii) reimburse the Servicer for the amount of any advance that is not recoverable from the general proceeds of the HELOCs.

Please note that this transaction would result in the servicing arrangement described in the first scenario, the only difference being that the Lender and the Servicer are separate entities.

D. Participation/Trust Certificates

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In the fourth scenario, the Investor does not acquire legal title to the HELOCs. Instead, the Lender transfers the HELOCs to an entity (the “Principal”) that issues a certificate to the Investor evidencing an undivided ownership interest in the HELOCs. The Investor and other certificate holders become the beneficial owners of the HELOCs.

The Principal in this arrangement is a Delaware statutory trust (the “Trust”) formed by the Investor. The Trust is administered by a trustee that is either licensed to originate mortgage loans or is exempt from licensing requirements (the “Trustee”). The Trust issues the certificate evidencing the beneficial ownership in the trust estate in exchange for funds used by the Trust to purchase the HELOCs. The Trust either acquires the HELOCs on a servicing-retained basis or the Trustee assigns servicing rights to a third-party Servicer. In either case, the Trust is obligated to provide funds to the Servicer for subsequent advances. The Investor and other certificate holders are obligated to purchase any incremental increase in the value of the certificates that results from the funding of an additional advance.

Alternatively, the Principal may be the Servicer, which directly purchases the loans from the Lender. The Servicer then issues and sells the participation certificate to the Investor. The Participation Agreement requires the certificate holder to purchase incremental increases in the value of the certificate that result from the funding of additional advances.

E. Total Return Swap Arrangement

The Servicer or Lender (for the purposes of this scenario, the “Counterparty”) purchases or retains the HELOCs, as applicable and enters into a swap arrangement with the Investor. Under the terms of this swap, the Investor does not own the HELOCs, but instead protects the Counterparty against any change in the market value of the HELOCs during the term of the contract. Accordingly, the Investor is entitled to payments equal to any income and payments earned on the HELOCs and is required to make payments to compensate the Counterparty for any loss incurred with respect to the HELOCs, including losses resulting from payments to fund any advances requested by the borrower. The swap contract includes a termination trigger. Upon termination, the Investor has the right to purchase the HELOCs from the Counterparty at a predetermined percentage of par. Prior to termination of the swap, ownership of the HELOCs remains with the Counterparty.

F. Fully-Funded Forward Commitment

In a forward commitment arrangement, the Servicer agrees to purchase the HELOCs from the Lender in consideration of the Investor’s obligation to purchase the HELOCs from the Servicer on a certain future date (the “Strike Date”). The agreement provides that the Investor will provide periodic and/or

preliminary funds (“Pre-Fundings”) to the Servicer as pre-performance payments with respect to the

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Investor's obligation to purchase the HELOCs on the Strike Date. On the Strike Date, the Investor will purchase the HELOCs from the Servicer at a price equal to: (i) a predetermined percentage of par plus any advances made by the Servicer that were not covered by the Pre-Fundings; or (ii) a predetermined percentage of par net of the amount of the Pre-Fundings that exceed the purchase price paid by the Servicer for the HELOCs.

Legal Analysis

Based upon the factual background described above, the MBBCEPA and SMLA are likely the only licensing statutes under the Department's jurisdiction that may be applicable to the activities of the Investor, Lender, Servicer and Trustee.²

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:

. . . 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

² First mortgage loans may also be originated by licensees under the Consumer Discount Company Act ("CDCA"), 7 P.S. § 6201 *et seq.* However, it does not appear from the factual background above that you anticipate the HELOCs being originated by CDCA licensees. Therefore, this letter does not analyze the activities of the Investor, Lender, Servicer, or Trustee under the CDCA.

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servicing such loans.

7 P.S. § 6603(a)(5) (emphasis added). In addition the SMLA provides that:

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

* * *

[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).

According to the factual scenarios above, it is the position of the Department that the Investor will not be engaging in the first mortgage loan business in Pennsylvania. Therefore, the Investor is not required to obtain a license under the MBBCEPA in order to engage in any of the proposed Investor activities described in this letter. Additionally, based upon the facts as stated in this letter, the Investor will not be making or servicing secondary mortgage loans. Therefore, it is the position of the Department that the Investor qualifies for the "investor" exception to the definition of "secondary mortgage loan business" contained in Section 3(a)(5) of the SMLA and is not required to obtain a license under the SMLA in order to engage in any of the proposed Investor activities described in this letter.

In regard to the Lender, Servicer and the Trustee, any entity that services secondary mortgage loans originated under the SMLA is required to be licensed under the SMLA, unless otherwise exempt from licensure. Additionally, the Lender is required to be licensed under the MBBCEPA and SMLA in order to originate first and secondary mortgage loans and service secondary mortgage loans originated under the SMLA, assuming that the Lender is not otherwise exempt from licensure under the MBBCEPA and SMLA.

Please be advised that this letter provides the Department's position on the applicability of the MBBCEPA and SMLA to the activities of the Investor, Lender, Servicer and Trustee, and does not address any other Federal or Pennsylvania law that is outside the Department's jurisdiction that may be applicable to the activities of the Investor, Lender, Servicer or Trustee.

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

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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,

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