Are Your Employees Taking Loan Applications? The Reach and Consequence of Mortgage Loan Originator Licenses

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One of the more nuanced licensing issues that can arise under state credit laws is the need for individual mortgage loan originators (MLOs) to be licensed. On its face, the MLO license seems relatively straightforward. Following the 2008 financial crisis, federal law required states to adopt mortgage loan originator licenses for individuals who take residential mortgage loan applications or offer or negotiate the terms of residential mortgage loans. However, there are a number of complexities that can arise in determining what activities trigger the license. A recent Connecticut case, *1st Alliance Lending LLC v. Department of Banking*, No. HHB-CV-21-6066325, 2023 WL 3071205 (Conn. Super. Ct. Apr. 19, 2023), illustrates that point.

The case involved a licensed mortgage company (the Company). To avoid some of the cost and burden associated with MLO licenses, the Company had only some of its origination employees licensed as MLOs. For the remaining employees, referred to as Home Loan Consultants (HLCs), the Company tried to eliminate the need for MLO licenses by limiting the activities of those employees. For example, the Company instructed the HLC employees to avoid taking the property address when speaking with a customer. Without a specific property address, the Company reasoned that the HLCs could not be deemed to be taking mortgage loan application. Further, the Company instructed the HLC employees not to quote interest rates or down payment requirements, concluding that without that information, the HLCs would not be negotiating or offering loan terms. With those operational limits in place, the Company thought that it had avoided the need for the HLCs to be licensed.

The problem was that strategy relied on a narrow interpretation of what it means to act as a mortgage loan originator. Also, in practice, the HLC employees sometimes did things they weren't supposed to do. The Company's own compliance audits found that the HLCs were sometimes acting as mortgage loan originators. During an examination, the Connecticut Department of Banking alleged that the Company and its employees were violating the MLO licensing requirement, among other things. After the Department revoked the Company's license and imposed a $750,000 penalty, the Company appealed. Unfortunately for the Company, the Superior Court of Connecticut upheld the Department's ruling.

Favoring the Department's interpretation of the law, the court took issue with the Company's limited view of what constitutes an MLO. Regardless of whether the HLC employees received a specific property address, the court found there was ample evidence they were taking residential mortgage loan applications. The court reasoned that in the real world, it was possible to negotiate mortgage loan terms based on a hypothetical property of specified appraised value.

The court also found that other operational practices hindered the Company's attempts to limit the HLC's activities. For example, the Company instructed the HLCs not to take property addresses from applicants, but at the same time, it provided commissions and prizes to incentivize the HLCs to close loans. As a result, there were instances where the HLCs actually did collect property addresses from prospective borrowers. That meant they were taking loan applications within even the Company's narrow interpretation of what it means to be an MLO.

The court did not seem overly surprised by that result, given that the HLCs were relatively low-level employees with limited training. Unlike a licensed MLO, who must be concerned with compliance or risk losing their license, the HLC employees had little incentive to worry about compliance issues. Rather, the Company's compensation practices made them more concerned with aggressive sales.

Similarly, the Company instructed the HLCs not to discuss interest rates or down payments, but then put them in a prime position to do just that - the Company sent out marketing and prequalification letters encouraging customers to contact the HLCs. The Company also had the HLCs run credit reports on the customers, so the employees knew about the applicant's credit information and circumstances. As a result, it probably wasn't surprising that there were instances where the HLCs were advising applicants on loan terms, meaning the employees fell within the MLO license by offering and negotiating loan terms.

The court upheld the DOB's large fine and revocation of the Company's license.

While there may be legitimate ways that a mortgage company can structure its operation to limit the number of employees who need MLO licenses, this case illustrates the need to be careful when doing so and to make sure that what you're doing on paper isn't undercut by what's happening in practice. The case also illustrates the significant penalties that can apply if you get it wrong.

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