

January 2, 2017

Minnesota Residential Mortgage Originators and Servicers

RE: Minnesota Department of Commerce 2017 Residential Mortgage Originator (RMO)
Supervisory Guidance

Dear Licensee:

The Minnesota Department of Commerce ("Department") has conducted a series of routine exams of Residential Mortgage Originators licensed in Minnesota to analyze compliance with State Statutes and Federal Regulations governing mortgage origination activities and create the formal document of record for the Department's Commissioner.

This letter is intended to bring attention to five common deficiencies the Department identified in routine examinations with respect to Minnesota Statutes. The Department asks that regular compliance reviews and quality control reviews be conducted to determine if corrective action is required in order to ensure compliance with the applicable laws and rules.

The common deficiencies are as follows:

1. **Agency versus Non-Agency:** Failure to properly disclose Agency relationships, the Non-Agency relationships of lenders, and Advance Fee Agreements according to Minnesota Statutes §§ 58.15, 58.16, and 58.161.
2. **Interest Rate Lock and Discount Point Agreements:** Failure to properly disclose the five requirements of the agreement, complete the agreement in entirety, and include a disclaimer that the statement of terms is not an offer according to Minnesota Statutes §47.206.
3. **Record Retention:** Failure to maintain for 60 months the business records, including advertisements, regarding residential mortgage loans applied for, originated, or serviced in the course of its business. This includes loan estimates, closing disclosures and all other loan origination documentation as required in Minnesota Statutes §58.14.
4. **Net Tangible Benefit:** Failure to demonstrate the tangible net benefit to a consumer for refinance loans and engaging in churning according to Minnesota Statutes §58.13, Subdivision 1(a)(25).
5. **Trust Funds and Advance Fees:** Failure to disclose proper advance fee contracts, deposit advance fees or escrows into a trust account according to Minnesota Statutes §58.13, Subdivision 1 and 2.

Included with this letter is a fact sheet which summarizes the common deficiencies, the applicable law, and the corrections required. If you find that your company is deficient in

any of the above noted items, please take corrective action immediately. Failure to do so may result in administrative disciplinary action and/or civil penalties of up to \$10,000 per violation pursuant to Minn. Stat. § 45.027, Subdivision 6 (2015).

Additionally, if you are no longer doing business as a residential mortgage originator in Minnesota, please follow the surrender instructions on the Nationwide Multistate Licensing System (NMLS) to surrender RMO licenses in Minnesota. See the website for further details: <http://nationwidelicensingsystem.org/slr/PublishedStateDocuments/MN-Residential-Company-Mtg-Originator-Surrender-Checklist.pdf>

If you have any questions you may contact us at 651.539.1720.

Sincerely,

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COMMON DEFICIENCIES

1. Agency versus Non-Agency:

Whether a Residential Mortgage Originator acts as a lender or Broker will generally determine the agency relationship with a borrower. Loans reviewed during examinations indicated Residential Mortgage Originators disclosed to the borrower, both a “non-agency” disclosure and an “agent” disclosure.

When the Residential Mortgage Originator acts as the lender of record and does not accept an advance fee, the non-agency disclosures should be signed by the borrower within three business days of accepting an application. The practice of executing in both capacities, as agent and non-agent, may be considered a violation of **Minnesota Statutes § 58.13, Subdivision 1(a)(17)**. This section states in part that licensees shall not represent to act as the borrower's agent after providing the non-agency disclosure required by section [58.15](#), unless the disclosure is retracted and the licensee or exempt person complies with all of the requirements of section [58.16](#).

In instances when the lender acts as a Broker, an agency agreement is required to be provided to the borrower in advance of the provision of services for fees collected. See **Minnesota Statutes §58.161**.

2. Interest Rate Lock and Discount Point Agreements:

Under **Minnesota Statutes §47.206, Subdivision 2**, a lender offering borrowers the opportunity to enter into an agreement in advance of closing shall disclose, in writing, to the borrowers at the time the offer is made: (1) a definite expiration date or term of the agreement, which may not be less than the reasonably anticipated closing date or time required to process, approve, and close the loan; (2) the circumstances, if any, under which the borrower will be permitted to close at a lower rate of interest or points than expressed in the agreement; (3) the steps required to process, approve, and close the loan, including the actions required of the borrower and lender; (4) that the agreement is enforceable by the borrower; and (5) the consideration required for the agreement.

Except as permitted by Minnesota Statutes §47.206, Subdivision 4, a borrower or lender may not maintain an action on an agreement unless the agreement is in writing expresses consideration, sets forth the relevant terms and conditions, and is signed by the borrower and the lender. The agreement shall set forth clear language to disclose if any circumstances would permit the borrower to close at a lower rate of interest and points. In addition, a lender may not offer or induce a borrower to accept an oral agreement and a borrower may not be permitted to orally accept an agreement, provided that if the borrower and lender have not executed a written agreement, the subdivision does not prohibit the offer and acceptance of an oral agreement which is offered and accepted during a period no greater than ten days before closing.

Many examinations revealed that management relies on the loan operating system generated forms. However, these forms were often incomplete, blank, or did not contain the requirements indicated above for an enforceable interest rate lock or discount point agreement. Licensees are encouraged to review the system generated forms for accuracy and conduct quality control reviews to ensure the forms are executed properly.

3. Record Retention:

Minnesota Statutes §58.14, Subdivision 5, states in part that a Residential Mortgage Originator must keep and maintain for 60 months the business records, including advertisements, regarding residential mortgage loans applied for, originated, or serviced in the course of its business.

Examinations revealed that brokers often do not retain copies of lender generated documents, such as loan estimates, closing disclosures, and other documents associated with the mortgage loans applied for, denied, or originated in the course of business. Minnesota Statutes do not contain an exemption for any residential mortgage originator from retaining the forms generated by another party to the mortgage transaction.

4. Tangible Net Benefit:

According to **Minnesota Statutes § 58.13, Subdivision 1 (25)**, a residential mortgage originator shall not engage in "churning." As used in this section, "churning" means knowingly or intentionally making, providing, or arranging for a residential mortgage loan when the new residential mortgage loan does not provide a reasonable, tangible net benefit to the borrower considering all of the circumstances including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances.

The lender or broker can demonstrate the borrower's concrete advantage to refinance a loan by soundly documenting the Tangible Net Benefit (TNB). Although the statutes do not require a disclosure signed by the borrower, detailing this information for the borrower will provide evidence of the decision to refinance a loan and create a rebuttable presumption of the absence of "churning."

Many examination files reviewed did not have a reasonable analysis of the TNB to borrowers. The TNB did not demonstrate the comparison of the borrower's current loan to the proposed loan, the cost of the new loan and the borrower's circumstances in order to comply with **Minnesota Statutes § 58.13, Subdivision 1 (25)**.

5. Trust Funds and Advance Fees:

"Trust Funds" are defined in **Minnesota Statutes §58.02, Subdivision 26** as "funds received by a residential mortgage originator or servicer in a fiduciary capacity for later

distribution, such as appraisal or credit report fees, taxes, or insurance premiums. Trust funds include commitment, lock, extended lock, and advance fees.” The residential mortgage originator shall deposit in a trust account, within three business days, all fees received before the time a loan is actually funded. The trust account must be in a financial institution located within the state of Minnesota, and, with respect to advance fees, the account must be controlled by an unaffiliated accountant, attorney, or bank according to **Minnesota Statutes § 58.16, Subdivision 4.**

In most of the examinations, advance fees or “Trust Funds” were collected in advance before closing and were not deposited into a Trust Account. No person acting as a residential mortgage originator or servicer shall fail to maintain a trust account to hold trust funds received in connection with a residential mortgage loan or fail to deposit all trust funds into a trust account within three business days of receipt. No residential mortgage originator or servicer shall commingle trust funds with funds belonging to the licensee or use trust account funds for any purpose other than that for which they are received.

Some lenders collected prepaid taxes and insurance payments at closing from the borrower, but did not deposit these funds into a Trust Account. Instead, these prepaid funds were deducted from the loan investors’ purchase price. According to **Minnesota Statutes 58.02, Subdivision 8**, an "Escrow Account" means a trust account that is established and maintained to hold funds received from a borrower, such as real estate taxes and insurance premiums, incurred in connection with the servicing of the mortgage. All escrow funds collected in a fiduciary capacity for later distribution, such as taxes and insurance premiums are “Trust Funds” and should be deposited into a Trust Account according to **Minnesota Statutes §58.13, Subdivision 2.** Licensees should correct the practice of netting prepaid escrows from the investor proceeds and deposit escrow funds into a separate Trust Account according to Minnesota Statutes.