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Substantive Policy Statement 2021-02 (DFI)¹

Loan Originator Employment and Compensation

Pursuant to Arizona Revised Statutes (“A.R.S.”) § 41-1091, the Arizona Department of Insurance and Financial Institutions (“Department”) occasionally issues Substantive Policy Statements to express the Department’s position on current industry practices and to provide the Department’s interpretation regarding Arizona law requirements. The Department’s Substantive Policy Statements are intended to promote a level playing field and uniform application of statutory provisions to consumers and industry stakeholders in Arizona.

I. Purpose

The purpose of this Substantive Policy Statement is to address (1) whether Arizona mortgage laws prohibit Arizona-licensed mortgage brokers and bankers from employing and compensating Arizona-licensed loan originators as independent contractors; and (2) what Arizona mortgage laws require concerning the branch license requirement for Arizona mortgage bankers and brokers who employ Arizona-licensed loan originators.

II. Scope

This Substantive Policy Statement is intended to provide regulatory guidance to all Arizona-licensed mortgage brokers and bankers that employ Arizona-licensed loan originators. This Substantive Policy Statement does not interpret, clarify, or otherwise provide a position on any other legal requirements outside of the stated Purpose above, including but not limited to any related state and federal tax and/or labor and employment laws over which the Department has no jurisdiction. Each mortgage banker, mortgage broker, and loan originator operating in Arizona is obligated to be familiar with all applicable legal requirements and to ensure compliance with state and federal laws.

III. Background

Arizona-licensed residential mortgage brokers and bankers (collectively, “AZ Mortgage Lenders”) historically have employed and compensated sponsored Arizona-licensed loan originators as company

¹ This Substantive Policy Statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona Administrative Procedure Act. If you believe that this Substantive Policy Statement does impose additional requirements or penalties on regulated parties you may petition the agency under section [41-1033](#), Arizona Revised Statutes, for a review of the statement.

employees that receive an annual IRS W-2 Form. Whether Arizona law requires this practice or expressly prohibits AZ Mortgage Lenders from employing and compensating Arizona-licensed loan originators as independent contractors warrants Department guidance. The Department, to date, has not issued any formal guidance or opinion on this question.

On March 11, 2021, the Department issued a Notice of Opportunity to Comment in which it stated it was considering a Substantive Policy Statement regarding what Arizona law establishes concerning the employment relationship required for Arizona-licensed loan originators. The Department solicited comments from interested parties relating to any legal authority the Department should consider and the practical effects of Arizona law on mortgage companies who employ loan originators. The Department received, reviewed, and considered numerous comments in the course of crafting this Substantive Policy Statement.

IV. Department Position

The mortgage lending industry in Arizona is subject to the statutory requirements of A.R.S. Title 6, Chapter 9. More specifically, A.R.S Chapter 9, Article 1 establishes the legal requirements for mortgage brokers (residential and commercial); Article 2 for residential mortgage bankers; Article 3 for commercial mortgage bankers; and Article 4 for loan originators. After reviewing all pertinent statutes and associated rules, the Department provides the following positions and guidance.

A. Arizona mortgage laws do not prohibit AZ Mortgage Lenders from employing and compensating Arizona-licensed loan originators as independent contractors

Arizona mortgage laws contain no express provision that prohibits AZ Mortgage Lenders from hiring and employing Arizona-licensed loan originators as independent contractors. Further, because Arizona's mortgage statutory framework contemplates the hiring of and employing independent contractors by AZ Mortgage Lenders, the relevant statutes reasonably cannot be construed to prohibit such a practice.

1. *Legal analysis*

To take a residential mortgage loan application or negotiate terms of a residential mortgage loan for compensation, Arizona law requires such person to be licensed as a loan originator and to be "employed" by an Arizona-licensed mortgage broker or banker. A.R.S. §§ [6-991.03\(A\)](#) and [6-991.02\(M\)](#). Once a loan originator license is approved, the Department must keep the license until an AZ Mortgage Lender "employs" the loan originator and the "employer" provides written notice that it has "hired" the loan originator. A.R.S. § [6-991.04\(B\)](#). At such time, the Department will forward the loan originator license to the "employing" AZ Mortgage Lender. *Id.* Arizona's mortgage laws broadly define the term "compensation"² and do not define the terms "employed," "employs," "employer," "hired", or "employing."

² A.R.S. Title 6, Chapter 9 supports the conclusion that an AZ Mortgage Lender can compensate loans originators through means other than an IRS W-2 Form. A.R.S. § [6-901\(5\)](#) and A.A.C. [R20-4-102\(6\)](#).

In giving meaning to those undefined terms, the Department must consider Arizona mortgage laws in their entirety before reaching a reasonable reading of what the law allows or prohibits.³ The Department concludes “employs” in A.R.S. § [6-991.04\(B\)](#) does not constitute only a W-2 employment relationship. Such a narrow reading would create a direct conflict with a key compensation and licensing provision of Arizona’s mortgage statutes.⁴ For example, AZ Mortgage Lenders “shall not pay compensation to, contract with or employ as an independent contractor” a person not licensed under any of the mortgage statutes in Title 6, Chapter 9, such as an unlicensed loan originator. A.R.S. §§ [6-909\(B\)](#) and [6-947\(B\)](#). Accordingly, this strongly suggests an AZ Mortgage Lender who pays compensation to and employs an Arizona-licensed loan originator as an independent contractor would not violate this statutory provision. The Department therefore interprets the above statutory use of “employed,” “employs,” “employer,” “hired”, and “employing” to include hiring employees⁵ under both W-2 and independent contractor scenarios.⁶

Furthermore, interpreting Arizona mortgage laws to require all AZ Mortgage Lenders to employ and compensate Arizona-licensed loan originators only on a W-2 basis would create an inequitable and absurd result.⁷ As noted previously, Arizona mortgage laws expressly contemplate that loan processors and underwriters may work and receive compensation as independent contractors if licensed as loan originators. Interpreting the statutes to allow only a W-2 employment scenario for licensees performing actual loan origination would create an absurd result where one type of person (loan processors) can be employed as an independent contractor if licensed but another type of person required to have the same license (loan originators) cannot, even though they are subject to the same regulatory requirements. Accordingly, no basis exists to interpret Arizona mortgage laws as restricting AZ Mortgage Lenders from hiring some employees as independent contractors but not others when both categories of employees maintain the same license.

³ See *Stambaugh v. Killian*, 398 P.3d 574, 575 (Ariz. 2017) (statutory language must be read in context with other provisions or relevant statutes and statute as a whole should be considered when construing specific provisions); *Ariz. Cannabis Nurses Ass’n v. Ariz. Dep’t of Health Servs.*, 392 P.3d 506, 512 (Ariz. App. 2017) (agencies may take action that can be reasonably implied from the statutory scheme as a whole).

⁴ See *Welch-Doden v. Robert*, 202 Ariz. 201 (Ariz. App. 2002) (statutes should be interpreted in a way that promotes consistency, harmony, and function).

⁵ Although “employee” is not an operative term found in A.R.S. §§ [6-991.03\(A\)](#), [6-991.02\(M\)](#), or [6-991.04\(B\)](#), both W-2 and independent contractor employees are contemplated under Arizona’s mortgage statutory framework. For example, a general Department rule (A.A.C. [R20-4-102\(13\)](#)) describes an “employee” in a W-2 employment scenario but loan processors and underwriters (statutorily defined as “employees” under A.R.S. § [6-991\(13\)](#)) can be independent contractors under A.R.S. § [6-991.02\(P\)](#) if such individual maintains a loan originator license and is employed by a licensed mortgage lender.

⁶ See *Kobald v. Aetna Life Ins. Co.*, 239 Ariz. 259, 262 (App. 2016) (if a statute is silent on a specific issue, the relevant inquiry is whether the agency’s interpretation is reasonable and that statutory ambiguities will be resolved within the bounds of reasonable interpretations).

⁷ See *France v. ICA*, No. CV-20-0068-PR, slip op. at 5, 12 (Ariz. Sup. Ct. 2021) (statutes should not be construed in a manner that produces absurd results); *State v. Harris*, 234 Ariz. 343 (Ariz. 2014) (statutes should be construed sensibly to avoid reaching an absurd conclusion).

In conclusion, the Department concludes that Arizona mortgage laws do not expressly or impliedly prohibit AZ Mortgage Lenders from electing to employ and compensate Arizona-licensed loan originators as independent contractors.

2. *Policy considerations*

As discussed above, the Department's position narrowly addresses one aspect of what Arizona mortgage laws require in regard to the employment relationship between AZ Mortgage Lenders and Arizona-licensed loan originators. The Department's position does not change, remove, or construe any loan originator licensing or conduct requirements, **including but not limited to:** (1) being reasonably supervised by an employer and prohibited to act on the loan originator's own behalf (A.R.S. §§ [6-991.02\(A\)](#), [6-909\(Q\)](#) and [6-947\(P\)](#)); (2) not being concurrently employed by more than one AZ Mortgage Lender (A.R.S. § [6-991.02\(E\)](#)); (3) disclosing if the loan originator also is receiving compensation for real estate broker or salesperson services (as applicable) (A.R.S. § [6-991.02\(F\)](#)); and (4) obtaining employer approvals to advertise (A.R.S. § [6-991.02\(N\)](#)). Similarly, the Department's position does not diminish an AZ Mortgage Lender's regulatory requirements in hiring and supervising its loan originators or affect the prohibited acts to which the AZ Mortgage Lender itself is subject. A.R.S. §§ [6-903\(Q\)](#) and (W); [6-943\(O\)](#) and (U); [6-909](#); and [6-947](#).

The Department maintains all of its regulatory powers and is able to take any enforcement action allowed by law for any substantiated findings of loan originator or mortgage lender misconduct, including, but not limited to, license suspension or revocation. A.R.S. §§ [6-905](#), [6-945](#), and [6-991.05](#). Additionally, bond requirements and relief through the mortgage recovery fund are unaffected by the Department's positions herein.

3. *Federal considerations*

The Department also analyzed relevant federal guidance regarding loan originator compensation requirements given the state regulatory interplay with federal law. The Department did not find any current federal mortgage laws or regulations that expressly prohibit compensating loan originators as independent contractors. To the contrary, various federal sources support the Department's position. For example, the Truth in Lending Act (Regulation Z) describes a loan originator's total compensation as consisting of a calculation involving one's wages and tips reported on IRS form W-2 "or, if the individual loan originator is an independent contractor, reportable compensation on IRS form 1099-MISC."⁸ The Department of Housing and Urban Development's rules relating to employee compensation do not prohibit compensation through IRS 1099 Form, only requiring that the employer "must report all employee compensation in accordance with IRS requirements."⁹ Lastly, the National Multistate Licensing System (NMLS) for loan originator licensing allows two options for worker classification – W2 employee or Non-W2 employee. Accordingly, the Department's position supports a uniform application of the regulatory requirements relating to the mortgage lending business.

⁸ [12 C.F.R. Part 1026-1026.36\(d\)\(1\)\(v\)\(A\)](#).

⁹ [HUD Handbook 4000.1\(I\)\(A\)\(3\)\(c\)\(iv\)\(B\)\(3\)\(b\)](#).

B. Branch office requirements

The Department received several public comments requesting Department guidance on branch licensing requirements considering the growing developments to a more remote working environment. In response, the Department provides the following guidance to all AZ Mortgage Lenders that employ Arizona-licensed loan originators, irrespective of the employment relationship or how compensation is paid.

Although Arizona remains a “brick and mortar state” requiring a mortgage lender to have a physical presence in the state to operate, technological advancements and the ability to conduct business remotely have diminished, if not eliminated entirely, the importance of physical location beyond satisfying Arizona’s physical presence and responsible individual requirements. Nevertheless, AZ Mortgage Lenders that “wish to maintain one or more locations [for the transaction of business in Arizona] in addition to a principal place of business” must obtain a branch office license from the Department and “designate a person for each branch office to oversee the operations of that office.” A.R.S. §§ [6-904\(H\)](#) and [6-944\(E\)](#). Arizona’s mortgage statutes and regulations do not define what it means to “maintain” a location but the Department interprets this provision to mean that the same actions (or materially similar actions) taken to satisfy Arizona’s physical presence requirement would be required at the additional location (within or outside of Arizona) in order to trigger a requirement for licensing it as a branch office. Although Department rules require consideration of advertising or “holding out to the public” in a branch office analysis,¹⁰ such terms should not be analyzed in a vacuum. Any interpretive rules must be implemented without ignoring what the law establishes to conduct mortgage business in Arizona in the first place – the AZ Mortgage Lender must designate and maintain the location for the transaction of business. A.R.S. §§ [6-904\(H\)](#) and [6-944\(E\)](#).¹¹

Therefore, the Department concludes that the physical location of a sponsored loan originator does not require the AZ Mortgage Lender to obtain a branch license for such location unless the AZ Mortgage Lender itself maintains such physical location in a similar manner to how it maintains its Arizona location to satisfy the physical presence requirement. Nonetheless, all Arizona-licensed loan originators must continue to have a licensing nexus to an Arizona-licensed location (within or outside of Arizona) of the employing AZ Mortgage Lender.

This Department position does not in any way modify or affect (1) each mortgage broker and banker’s responsibility under A.R.S. §§ [6-909\(Q\)](#) and [6-947\(P\)](#) to reasonably supervise the activities of its loan originators; or (2) the advertising requirements for loan originators, mortgage brokers, and mortgage bankers under A.R.S. §§ [6-991.02\(C\)](#) and (N), [6-903\(P\)](#), and [6-943\(N\)](#). The Department will continue to enforce Arizona mortgage laws against those that fail to reasonably supervise their sponsored Arizona-licensed loan originators regardless of the employment relationship or compensation structure.

¹⁰ Department rules define a “branch office” as a location where the “licensee holds out to the public that the licensee acts as a licensee.” A.A.C. [R20-4-102\(4\)](#) and (17). “Holding out to the public” means advertising or otherwise informing the public that mortgage loans are made or negotiated at a location. A.A.C. [R20-4-102\(17\)](#).

¹¹ The statutory requirement that the licensee designate a person to oversee the operations of a branch office further emphasizes the importance that the mortgage lender maintain such office. Requiring an AZ Mortgage Lender to designate a person to oversee an office which it does not maintain would result in an absurd scenario.

As of the issuance date below, the Department will process all license applications and base all enforcement decisions in accordance with the positions stated herein.

Questions regarding this Substantive Policy Statement may be directed to our Regulatory Legal Affairs Officer at deian.ousounov@difi.az.gov.

Issued April 23, 2021