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NRMLA West

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New Rules for Loan Originator Compensation

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Introduction

Topics to Cover:

- Scope of coverage
- LO Compensation: What is prohibited? What is permitted?
  - Prohibition on steering
  - Record retention requirements
  - Examples and Questions
- In the Future - Dodd-Frank Act will change some of these Rules
- Other statutes to be considered in addressing loan originator compensation: RESPA, FHA (FHA TPO Rules), Fair Lending, Fair Labor Standards Act

Introduction

- On August 16, 2010, the Federal Reserve Board issued a final rule to address loan originator compensation practices – 75 Fed. Reg. 185 (Sept. 24, 2010)
- Amends Regulation Z, implementing Truth in Lending
  - Does NOT implement Dodd-Frank Act provisions on originator compensation
- Stated goals of the new rule:
  - Protect mortgage borrowers from unfair, abusive, or deceptive lending practices; and
  - Help ensure that consumers can choose from loan options that include the lowest interest rate and lowest amount of points and origination fees

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Introduction

- Effective date: April 1, 2011
  - Applies to any covered transaction for which the ***creditor*** ***receives*** an application on or after April 1, 2011

- Litigation:
  - NAIHP field Suit Against the Board of Governors of the Federal Reserve System on March 7, 2011 seeking, among other things, injunctive and declaratory relief from the Rule
  - NAMB filed Suit Against the Board on March 9, 2011
  - On March 10, 2011, a Motion was made by the Board to Consolidate the Suits
  - Preliminary Arguments may not be heard until week of March 28th

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Introduction

Three main prohibitions in the new rule:

- Compensation based on loan terms or conditions: Loan originators may not receive compensation that is based on loan terms or conditions, other than loan amount (“*Terms and Conditions*” prohibition)

- Compensation from multiple sources: Loan originators may not receive compensation from the lender or other parties if the loan originator is receiving compensation directly from the consumer (“*Dual Source*” prohibition)

- Steering: Loan originators are prohibited from directing or “steering” a consumer to accept a mortgage loan that is not in the consumer’s interest to increase the loan originator’s compensation (“*Steering*” prohibition)

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Scope of Coverage

What transactions are covered by the new rule?

- All closed-end consumer credit transactions secured by first or subordinate liens on a dwelling that are subject to TILA
  - ***Includes closed-end reverse mortgage transactions***
- All owner occupancies (first and second homes)
- All lien positions

What transactions are *not* covered by the new rule?

- Open-end loans (*e.g.*, HELOCs); ***Excludes open-end reverse mortgage transactions***
- Timeshares
- Loan modifications not rising to level of a refinance under Reg. Z
- Loans secured by real property that do not include a dwelling (*i.e.*, vacant land)
- Loans not "covered" by TILA (*e.g.*, business purpose loans, such as a loan secured by a home purchased for use as a rental property)

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Scope of Coverage

Is compensation from Secondary Market Transactions covered?

- **Generally does not cover transactions that occur between creditors and secondary market purchasers, to which consumers are not a direct party**
  - **Does not apply to payments received by a *creditor* when selling the loan to a secondary market investor**
  - **However, when a *mortgage brokerage company* brokers a loan to a creditor, the brokerage company is not exempt from the new rule**
  - **If creditor is table funded, that entity is a Loan Originator for purposes of the Rule and its compensation is subject to the Rule**
  - **FRB Staff have stated informally they will look to HUD's informal guidance under RESPA on "true source of funds" to interpret this provisions of Reg. Z**
  - **HUD Issued NPR on Nov. 24, 2010 regarding Warehouse Lending and RESPA**
- **The prohibitions on compensation to loan originators ("LOs"; *i.e.*, loan officers and mortgage brokers) extend to *all persons*' payments to an LO, not just the creditor's payment to an LO, to prevent evasion by structuring payments to LOs through non-creditors, such as secondary market investors**

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Scope of Coverage

Whose compensation is subject to the new rule?

- **A "loan originator": a person, *with respect to a particular transaction*, who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, *arranges*, *negotiates*, or *otherwise obtains* an extension of consumer credit for another person**
  - **Includes payments to both a natural person and an entity:**
    - **Individuals (brokers and loan officers) employed by mortgage brokers, mortgage bankers and financial institutions who, for compensation, arrange, negotiate or otherwise obtain a consumer loan for another person; and**
    - **Mortgage broker companies**
  - **Applies to payments to a *creditor* that closes a loan in its name, but uses table-funding from a third party to fund the loan**

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Scope of Coverage

Whose compensation is NOT subject to the new rule?

- **Creditors that originate loans closed in their own names and with their own source of funds**
- **Servicers modifying an existing loan on behalf of the current owner**
    - **Loan modification must not constitute a *refinancing* as defined under Reg. Z ("when an existing obligation [that was subject to TILA's disclosure requirements] is satisfied and replaced by a new obligation undertaken by the same consumer")**
- **Managers, administrative staff and other employees of creditors and loan originators:**
    - **Who do not originate loans *and***
    - **Whose compensation is not based on whether any *particular loan* is originated**

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LO Compensation

What is "compensation?"

- **Fees the loan originator retains or keeps, regardless of the label or name given or associated with the fee**
- **Salaries, wages, commissions, and *any* financial or similar incentive, including:**
  - **Annual or periodic bonuses; and**
  - **Awards of merchandise, services, trips, or similar prizes**

What is *not* "compensation?"

- **Amounts a broker receives and passes through for *bona fide* and reasonable third party charges (*e.g.*, title insurance or appraisals)**
- **Amounts the loan originator retains or keeps resulting from unintentional overcharges of *bona fide* and reasonable third party charges**

LO Compensation

<u>Loan terms or conditions</u>: No loan originator shall receive and no person shall pay a loan originator directly or indirectly, compensation based on any of the loan terms or conditions

•What is a loan term or condition? No express definition, but examples provided:

- **Interest rate**
- **Annual percentage rate**
- **LTV ratio**
- **Prepayment penalty**
- **A factor that, while not itself a loan term or condition, serves as a proxy for a loan term or condition (*e.g.*, credit score or DTI ratio)**

•One express exclusion also provided:

- **Loan amount (when the loan originator's compensation is based on a *<u>fixed</u>* percentage of the loan amount)**

<u>Practice Example</u>: May compensation be based on either loan type/product or loan purpose?

- **Loan type/product (*e.g.*, conventional, FHA, VA) = Maybe, per recent informal FRB staff guidance; Caution is dictated**
- **Loan purpose (*e.g.*, purchase, refinance) = YES**

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LO Compensation

What is the "Loan Amount" for purposes of a Reverse Mortgage?

- **Loan amount or "Amount of credit extended" (when the loan originator's compensation is based on a *fixed* percentage of the loan amount) is not a "term and condition" for purposes of the LO Comp Rule**
- **NRMLA commented to the FRB that, for purposes of reverse mortgages subject to the Rule, "loan amount" should equate to the "maximum claim amount"**
- **NRMLA is waiting on a response from the Fed on this issue and is considering issuing a best practices bulletin in this regard**
- **Use of Initial Principal Limit Appears Acceptable**
- **Use of Initial UPB may be problematic under the Rule**

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LO Compensation

What are permissible compensation methods?

Compensation based on:

- **A fixed percentage of the loan amount, where the fixed percentage remains the same for all loans (no "tiers" based on loan amount)**
    - **Fixed minimum or maximum dollar amounts permitted**
- **Overall loan volume (*i.e.*, total dollar amount of credit extended or total number of loans originated) delivered to the creditor**
- **Long-term performance of the originator's loans**
- **An hourly rate of pay to compensate the originator for the actual number of hours worked**
- **Whether the consumer is an existing or a new customer**
- **Payment that is fixed in advance for every loan the originator arranges for the creditor (*e.g.*, $600 for every loan arranged for the creditor, or $1,000 for the first 1,000 loans arranged and $500 for each additional loan arranged)**
- **Percentage of applications submitted by the loan originator to the creditor that result in consummated transactions**
- **Quality of the loan originator's loan files (*e.g.*, accuracy and completeness of the loan docs) or**
- **Legitimate business expenses, such as fixed overhead costs**

LO Compensation

What are permissible compensation methods?

- **Creditor may pay different Loan officers differently**
- **Creditor may pay Loan officers differently from third party mortgage brokers**

- **Problem with Mortgage Brokerage Companies Paying its Loan Officers other than Salary or an Hourly Wage when Borrower pays Mortgage Brokerage Company Directly**
- **This "Rule" May Raise problems for CA DRE Licensed Mortgage Brokerage Operations**

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LO Compensation

Can LO compensation be revised? If so, when?

- **YES – <u>Periodic revisions</u>: A creditor or other person paying a loan originator may periodically revise the loan originator's compensation prospectively, so long as the revised compensation is not based on a loan's terms or conditions**
  - **Factors such as loan performance, loan volume, and current market conditions may be reviewed and a loan originator's compensation revised prospectively based on that review**

<u>Practice Tip</u>: Federal Reserve Board Staff Commentary to the rule contemplates a periodic revision to compensation after six months. While this is not a minimum or maximum threshold, a periodic revision conducted more frequently may be subject to higher scrutiny.

- **NO – <u>Modification of loan terms</u>: When a creditor offers a loan with specific terms and conditions, and subsequently, different terms or conditions are negotiated for that loan, the loan originator's compensation for that loan <u>*may not*</u> increase <u>*or decrease*</u> based on the renegotiated terms or conditions**
  - **No changes in LO compensation even if such a modification benefits the consumer (*e.g.*, waiving fees, lowering interest rate, increased credit, etc.)**
- **May a creditor require a loan originator to pay for fees that the loan originator fails to collect and/or include on the GFE? No.**

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Prohibition on Steering

How does the Rule prohibit "steering?"

•Loan originators are prohibited from ***directing or ''steering''*** a consumer to a dwelling-secured loan based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the originator offered or could have offered, unless the consummated transaction is ***in the consumer's interest***

- ***Directing or "steering"*** = advising, counseling, or otherwise influencing a consumer to accept a particular dwelling-secured loan
- Transaction must be closed

Prohibition on Steering

What does it mean to be "in the consumers interest?"

•The transaction must be compared to other ***possible loan offers available*** through the originator (if any) for which the consumer was ***likely to qualify*** at the time of the transaction

- Possible loan offer = an offer that the creditor likely would extend upon receiving an application from the consumer (*i.e.*, offer does not need to actually be extended)
- Available = loan could be obtained from a creditor with which the loan originator regularly does business
- Likely to qualify = based on creditor's standards and credit terms at the time of the transaction
  - Good faith belief
  - Based on information reasonably available
  - May rely on information provided by consumer, even if subsequently determined to be inaccurate
  - Loan originator not expected to know all aspects of creditor's underwriting criteria (only pricing and other information creditors routinely communicate to loan originators, such as rate sheets and minimum credit scores)

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Prohibition on Steering

Three ways to satisfy the prohibition:

1. Creditor employees: Loan originator employees of creditors must comply with the provisions of the rule prohibiting compensation based on loan terms and conditions in originating loans for their creditor-employers (*i.e.,* loan not "brokered" to another creditor) and are thus deemed to comply with the steering prohibitions
   - Employee loan originators must comply with either 2 or 3 below when brokering a loan to another creditor
2. Safe harbor: Satisfy the safe harbor requirements
3. Least amount of compensation: The loan originator reviews possible loan offers available from a ***significant number of creditors*** with which the originator ***regularly does business*** and directs the consumer to the transaction that will result in ***the least amount of creditor-paid compensation*** to the loan originator

Practice Tip: Can loan officers' compensation for brokering loans be separated from their compensation for loans originated through their employer-creditor?
•Yes. The compensation a creditor pays to its employee loan officer for originating the creditor's loans can be different from the compensation it pays to that loan officer for brokered loans.

Prohibition on Steering

- Significant number of creditors = 3 or more creditors with whom loan originator regularly does business
  - If loan originator regularly does business fewer than 3 creditors, loan originator is deemed to comply by obtaining offers from all creditors with whom it regularly does business
- Regularly does business = a loan originator regularly does business with a creditor if:
  - There is a written agreement between the originator and the creditor governing the originator's submission of mortgage loan applications to the creditor;
  - The creditor has extended credit secured by a dwelling to 1 or more consumers during the current or previous calendar month based on an application submitted by the loan originator; or
  - The creditor has extended credit secured by a dwelling 25 or more times during the previous 12 calendar months based on applications submitted by the loan originator.
    - For this purpose, the previous 12 calendar months begin with the calendar month that precedes the month in which the loan originator accepted the consumer's application

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Prohibition on Steering

How is the Safe Harbor satisfied?

1. Consumer must be presented with loan options from a significant number of the creditors with whom the loan originator regularly does business, that include:
   - A loan with the lowest interest rate;
   - A loan with the lowest interest rate with no risky features (*e.g.*, for reverse mortgages, no prepayment penalty or shared equity, shared appreciation); and
   - A loan with the lowest total dollar amount for origination points or fees and discount points
2. If more than 3 loan options are presented for each type of transaction, loan originator should highlight the 3 loan options which meet the above criteria; and
   - Less than 3 loan options for each type of transaction may be presented if the option(s) presented satisfy the above criteria (*e.g.,* 1 loan meets all the requirements)
3. Loan originator believes in good faith that the consumer likely qualifies for the loan options presented

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Prohibition on Steering

What is <u>not required</u> by the anti-steering provisions?

- **Loan originator is not required to meet the safe harbor requirements**
  - **Failure to satisfy the safe harbor does not subject the loan originator to any presumption that the loan originator failed to comply with the anti-steering provisions of the rule**
- **Loan originator is not required to establish a business relationship with any new creditors**
- **Loan originator is not required to inform a consumer about a potential transaction if the originator makes a good faith determination that the consumer is not likely to qualify**
- **Loan originator is not required to direct a consumer to the transaction that will result in a creditor paying the least amount of compensation to the originator**

<u>Practice Tip</u>: What is a creditor's liability for a broker violation of the prohibition on steering?

•A creditor's liability for a broker's violation with the steering provisions is not addressed under the Rule
•We strongly recommend that creditors impose a requirement on brokers to deliver a copy of a document evidencing compliance with these provisions (*i.e.*, a borrower-signed document showing that s/he was offered loan options meeting the safe harbor)

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Record Retention Requirements

What records must be maintained? For how long?

•***Creditor*** **must maintain records showing:**

- **Compensation paid to a loan originator on a transaction and**
- **The compensation agreement in effect on the date the interest rate was set for the transaction**
  - **Rate is set when the rate is locked/re-locked or re-priced**

•If the loan originator is a broker, a disclosure of compensation or other mortgage broker agreement required by state law would be presumed to be a record of the amount paid to the loan orignator

- **Retention period should comply with Reg. Z – *2 years* after the date disclosures are required to be made or action is required to be taken – or any other period required by state law**

Practice Tip: Although the FRB Rule does not impose record keeping requirements on brokers, brokers will need to keep adequate records demonstrating their compliance with the safe harbor provisions.

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Other Issues

- Inter-Play with Dodd-Frank Wall Street Reform & Consumer Protection Act
- RESPA
- FHA (TPO Rules)
- Fair Lending Laws
- State Law
- FLSA (Fair Labor Standards Act)
  - ➢ How to Compensate Retail Loan Officers (Exempt/Non-Exempt)

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LO Compensation

Practice Pointers, Examples and Questions

- **The Rule does not apply to variable rate HECMs (generally open end), but RESPA does apply to Wholesale Compensation models**
- **If the consumer pays the loan originator, that payments is not subject to the limitation on "Terms and Conditions" (but when does a Consumer pay a Loan Officer Directly?)**
- **If a Loan Originator that is an Employee of a Creditor meets the "Terms and Conditions" test, then the Steering prohibition does not apply, as long as that person is not "brokering"**
- **So, for Retail Loan Officers, the primary prohibition is the Terms and Conditions test (the 2nd part of the 3 part test)**
- **For Wholesale, all 3 parts for the Rule apply (Terms and Conditions , Dual Source limits and prohibition on Steering)**

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Questions

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