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Special Session on New Loan Originator Compensation and Anti-Steering Restrictions

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3:00 pm to 5:00 pm

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- Moderator:
 - Tamara King, MBA
- Panelists:
 - Rich Andreano, Patton Boggs LLP
 - Bill Dyson, CitiMortgage
 - David Hay, SunTrust Mortgage, Inc.
 - Ken Markison, MBA

- Final rule issued on August 16, 2010 amends Truth in Lending Act (TILA) regulation (Regulation Z) to add three main prohibitions on loan originator compensation.
 - Rule adopted based on HOEPA unfair/deceptive authority.
- Rule prohibits:
 - Basing loan originator compensation on loan terms or conditions, subject to exception **for loan amount**.
 - Compensation of loan originator by both consumer and party other than consumer for same transaction (dual compensation).
 - Steering based on ability of loan originator to receive greater compensation.
- Rule finalizes earlier Fed proposal. Later rulemaking will address Dodd-Frank prohibitions.

- Mandatory compliance with rule is required for applications received by creditors on or after April 1, 2011.
 - Receipt of application by broker before April 1, 2011 is not determinative.
- Rule generally applies to closed-end consumer credit transactions secured by dwelling.
- Rule requires creditors and other parties who compensate loan originators to retain records for at least two years after consummation of transaction.

- Rule applies to “loan originators,” who are persons who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arrange, negotiate or otherwise obtain extension of consumer credit for another person.
 - Includes individuals and entities.
 - Includes creditor employees who meet definition, mortgage broker employees who meet definition, and mortgage broker companies.
 - Includes mortgage broker companies, and even creditors, for particular transaction using table funding and not funding loan out of their own resources, such as deposits or warehouse line of credit.

- All closed-end consumer credit transactions secured by dwelling.
 - Lien position does not matter.
 - Reverse mortgages are covered.
- Excluded:
 - HELOCs.
 - Credit transactions secured by timeshare plans.

- Payments to creditors in connection with origination of a loan, when the creditors fund out of their own resources or use a bona fide warehouse line (i.e., not using table funding).
 - But compensation of employees who are loan originators is covered.
- Payments to creditors for selling loans to secondary market investors.
- Loan servicers when they modify existing loan on behalf of current owner of loan.
- Mortgage brokerage firms when acting as creditors and funding loan from their own resources.
- Managerial employees who do not originate loans and who are not compensated based on a particular loan closing.

- Rule **generally** provides no loan originator may receive and no person may pay to loan originator, directly or indirectly, compensation in any amount based on any of transaction's terms or conditions.
 - *Compensation includes amounts retained by loan originator, not bona fide and reasonable charges of third parties that are not retained.*
- Both increasing and decreasing loan originator's compensation based on transaction's terms or conditions are prohibited.
- Varying of loan originator's compensation based on factors that serve as proxy for transaction's terms or conditions also prohibited.

- Prohibition against compensation based on terms or conditions of transaction does not prohibit compensation:
 - Based on fixed percentage of amount of credit extended, even if there are minimum or maximum dollar amounts (minimum to encourage small loans).
 - Percentage may not vary based on transaction's terms or conditions.
 - Minimum or maximum dollar amounts may not vary per loan.
 - Fixed in advance for each loan of loan originator (and may account for fixed overhead costs).

- Prohibition against compensation based on terms or conditions of transaction:
 - Does not apply to compensation received by loan originator from consumer, either in cash or out of loan proceeds.
 - But dual compensation to originator—from consumer and another party—is prohibited.
 - Does not prohibit different compensation terms for loan originators.
 - Retail versus wholesale.
 - Retail versus retail.
 - Wholesale versus wholesale.

- Prohibition against compensation based on terms or conditions of transaction does not prohibit compensation:
 - Based on percentage of loan originator's applications that result in closed loans.
 - Based on long-term performance of loan originator's loans.
 - Based on quality of loan originator's loan files.
 - Based on overall loan volume (in numbers or dollars) of loan originator.
- Fed decided not to adopt comment expressly permitting variance in compensation based on geography.
 - Believes ability to vary compensation based on costs, including fixed overhead, is sufficient.

- Rule provides that if any loan originator receives compensation directly from consumer in transaction:
 - No originator may receive compensation, directly or indirectly, from any person other than consumer in connection with transaction.
 - No person who knows or has reason to know of consumer-paid compensation to loan originator (other than consumer) may pay any compensation to loan originator, directly or indirectly, in connection with transaction.

- Rule provides that loan originator may not direct or “steer” consumer to consummate transaction based on fact that originator will receive greater compensation from creditor in that transaction than in other transactions originator offered or could have offered to consumer, unless consummated transaction is in consumer’s interest.
 - Safe harbor may be available.
- For loan originators who are employees of creditors, they are deemed to comply with prohibition when originating loans for employer-creditor if there is compliance with prohibition against receiving compensation based on terms or conditions of consumer credit transaction.
 - But if creditor’s employee forwards an application to another creditor, steering prohibition applies.

- Elements of safe harbor from steering prohibition include:
 - For each type of transaction in which consumer expresses interest, consumer is presented with loan options that include:
 - Loan with lowest interest rate.
 - Loan with lowest total dollar amount for origination points or fees and discount points.
 - Loan with lowest interest rate and no risky features such as negative amortization, prepayment penalty, interest-only payments, balloon payment in first 7 years of loan, demand feature or shared equity or appreciation.
 - Presenting more than four options for each type of loan likely not helpful to consumer.

- Elements of safe harbor from steering prohibition include:
 - Loan originator must *obtain* loan options from significant number of creditors with whom originator regularly does business.
 - Three or more creditors is considered significant.
 - If originator regularly does business with less than three creditors, element is satisfied if options are obtained from all creditors with whom originator does business.
 - Consumer does not have to be presented with all loan options that originator obtains, as long as option presentation element is satisfied.
 - Loan originator must believe in good faith that consumer likely qualifies for options presented.

- Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) also includes prohibitions on mortgage originator compensation.
- Prohibitions are similar, but not identical, to prohibitions under Fed rule.
- Fed advised that it will assess Dodd-Frank prohibitions and engage in future rulemaking. Dodd-Frank prohibitions not yet effective.
- Dodd-Frank prohibits:
 - Basing mortgage originator compensation on loan terms, subject to exception for compensation based on loan amount.
 - Dual compensation of mortgage originators (with twist).
 - Various steering and related conduct by mortgage originators.

Key Differences From Fed Rule

- No exclusion from dual compensation restriction for compensation paid by consumer.
- If creditor will compensate loan originator:
 - Consumer may not compensate loan originator; *AND*
 - Consumer may not make an upfront payment of discount points, origination points, or fees (other than bona fide third party charges not retained by mortgage originator, creditor or affiliate).
 - Regulatory waivers or exemptions to the condition are permitted if deemed to be in the interest of the consumer and public interest.
- Steering prohibitions are much broader and apply to creditors in addition to mortgage originators.

- We now turn to examples to help explain the Fed rule.
- Examples address both retail and wholesale situations.
- CAVEATS:
 - With examples addressing compensation arrangements in the wholesale context, even if the example notes that the compensation would be permissible with regard to the loan term or dual compensation prohibitions, compliance with the steering prohibition also is required.
 - Examples are intended to highlight aspects of the rule. Other requirements must be assessed in evaluating any compensation program, including RESPA, fair lending, safety and soundness and investor requirements.

- Example 1 (Retail and Wholesale—Loan Terms).
- Consumer originally quoted 5% rate with 1 origination point.
- To meet competition, loan originator will take 0.5 point less in commission from creditor and pricing is changed to 5% rate with 0.5 point.
- Permissible or not?
- Not permissible. While pricing to consumer may be adjusted, compensation to loan originator may not increase or decrease based on loan pricing.

- Example 2 (Retail and Wholesale—Loan Terms).
- Consumer quoted 5% rate with 1 origination point and consumer will pay all fees.
- To meet competition, loan originator will receive standard compensation of X% from creditor, but will pay fees of the consumer, either directly or through a credit, up to 0.5% of the loan amount.
- Permissible or not?
- Not permissible. Fed informally advised that it views this to be the same as a pricing concession addressed in the prior slide.

- Example 3 (Wholesale—Loan Terms).
- Mortgage broker charges standard commission of 2%. Consumer initially decides to take loan with 4% interest rate and pay broker commission in cash.
- Consumer later wishes to lower upfront costs and broker is able to obtain loan with rate of 4.5% with lender paying 2% broker commission, and this is only compensation received by broker.
- Permissible or not?
- Permissible. Changes in pricing to consumer is not restricted. However, loan originator compensation may not be based on, or change because of, loan terms or conditions.

- Example 4a (Retail—Loan Terms).
- Mortgage company offers incentive promotion to loan officers.
- Loan officer with highest average interest rate and discount point combination each month receives fabulous prize.
- Permissible or not?
- Not permissible. Compensation includes:
 - Commissions and any financial or similar incentive.
 - Annual or other periodic bonus.
 - Awards of merchandise, services, trips or similar prizes.
- And compensation **to originators** can't be based on loan terms.

- Example 4b (Wholesale—Loan Terms).
- Mortgage company offers incentive promotion to mortgage brokers.
- Mortgage broker with highest average interest rate and discount point combination each month receives fabulous prize.
- Permissible or not?
- Not permissible. Compensation includes:
 - Commissions and any financial or similar incentive.
 - Annual or other periodic bonus.
 - Awards of merchandise, services, trips or similar prizes.
- And originator compensation can't be based on loan terms.

- Example 5a (Retail—Loan Terms).
- Mortgage company offers incentive promotion to loan officers.
- Loan officer with highest dollar amount of originations each month receives trip to Toledo (undisclosed if Ohio or Spain).
- Permissible or not?
- Permissible. Trip is compensation, but compensation can be based on volume of loans, by dollar or number, in given period.

- Example 5b (Wholesale—Loan Terms).
- Mortgage company offers incentive promotion to mortgage brokers.
- Mortgage broker with highest dollar amount of originations each month receives trip to Toledo (undisclosed if Ohio or Spain).
- Permissible or not?
- Permissible. Trip is compensation, but compensation can be based on volume of loans, by dollar or number, in given period. But be mindful of RESPA Section 8.

- Example 6a (Retail—Loan Terms).
- Mortgage company offers bonus compensation to loan officers.
- Loan officers qualify for additional compensation if they originate certain number or dollar volume of loans each quarter.
- Permissible or not?
- Permissible. Compensation can be based on volume of loans, by dollar or number, in given period.

- Example 6b (Wholesale—Loan Terms).
- Mortgage company offers bonus compensation to mortgage brokers.
- Mortgage brokers qualify for additional compensation if they originate certain number or dollar volume of loans each quarter.
- Permissible or not?
- Permissible. Compensation can be based on volume of loans, by dollar or number, in given period. But be mindful of RESPA Section 8.

- Example 7a (Retail—Loan Terms).
- Mortgage company offers bonus compensation to loan officers.
- Loan officers qualify for additional compensation if they originate certain number or dollar volume of loans each quarter.
 - Bonus payments conditioned on mortgage company achieving certain overall level of profit during each quarter (not tied to individual loan terms) in its retail operations.
- Permissible or not?
- Risky business. Fed informally expressed concern. Profits generally will be higher if higher rates and fees charged for loans. No safe harbor under rule for conditioning additional compensation on profit trigger.

- Example 7b (Wholesale—Loan Terms).
- Mortgage company offers bonus compensation to mortgage brokers.
- Mortgage brokers qualify for additional compensation if they originate certain number or dollar volume of loans each quarter.
 - Bonus payments conditioned on mortgage company achieving certain overall level profit during each quarter (not tied to individual loan terms) in its wholesale operations.
- Permissible or not?
- Risky business. Fed informally expressed concern. Profits generally will be higher if higher rates and fees charged for loans. No safe harbor under rule for conditioning additional compensation on profit trigger. Be mindful of RESPA Section 8.

- Example 8 (Retail and Wholesale—Loan Terms).
- Mortgage company will pay commission based on loan amount as follows:
 - 3% up to \$100,000.
 - 2% over \$100,000, up to \$300,000.
 - 1% over \$300,000.
- Permissible or not?
- Not permissible. Compensation may be paid based on fixed percentage of loan amount, not percentage that varies based on loan amount.

- Example 9 (Retail and Wholesale—Loan Terms).
- Mortgage company will pay commission based on loan amount as follows:
 - 1.5% of loan amount with \$1,500 minimum payment and \$5,000 maximum payment for all loans.
- Permissible or not?
- Permissible. Compensation may be paid based on fixed percentage of loan amount, and be subject to minimum and maximum dollar amount that does not vary per loan.

- Example 10 (Retail and Wholesale—Loan Terms).
- Mortgage company will pay commission that varies based on credit score of borrower.
- Permissible or not?

• Problematic. Compensation may not be based on factor that is proxy for loan term or condition. Fed provides this example of violation for situation in which creditor varies interest rate and commission based on credit score:

	Creditor A	Creditor B
Credit Score	650	800
Interest Rate	7.0%	6.5%
Commission	\$1,500	\$1,000

- Example 11 (Retail and Wholesale—Loan Terms).
- Mortgage company will pay periodic bonus if loan originator achieves certain performance levels for:
 - Number of loan applications that result in closed loans.
 - Quality of loan files (e.g., accuracy and completeness of documents).
 - Level of early payment defaults on loans originated by loan originator during the period (rate for all loans originated and not a per loan basis).
- Permissible or not?
- Permissible. Compensation may be based on one or more of these factors.

- Example 12 (Retail and Wholesale—Loan Terms).
- Mortgage company establishes commission structure with different commission amounts for conventional and FHA loans.
- Permissible or not?
- Apparently not permissible. In supplementary information Fed advises that compensation cannot vary based on loan type or program. But can take into account fixed costs, including overhead.

- Example 13 (Retail and Wholesale—Loan Terms).
- Mortgage company establishes commission structure with different commission amounts for purchase money and refinance loans.
- Permissible or not?
- It depends.
- Fed informally advised that if loan terms vary based on whether loans are purchase money or refinance loans, then proxy issued is presented. But can take into account fixed costs, including overhead.

- Example 14 (Retail and Wholesale—Loan Terms).
- Bank establishes commission structure with different commission amounts for CRA loans versus non-CRA loans so as to encourage origination of CRA loans.
- Permissible or not?
- Not permissible. Fed advises in supplementary information that allowing compensation to vary based on whether a loan is eligible for consideration under CRA is not permissible. But can take into account fixed costs, including overhead.

- Example 15 (Retail—Loan Terms).
- Bank establishes commission structure with different commission amounts for loans to consumers who are existing bank customers.
- Permissible or not?
- Permissible. Rule expressly permits variance in compensation based on whether or not the consumer is an existing customer.

- Example 16 (Retail versus Wholesale—Loan Terms).
- Mortgage company establishes commission structure under which it pays employee loan officers 1% per loan and mortgage brokers 2% per loan.
- Permissible or not?
- Permissible. Fed rule does not require that all loan originators receive same compensation, as long as no loan originator's compensation varies based on loan terms.

- Example 17a (Retail—Loan Terms).
- Mortgage company enters into commission agreements with employee loan officers. Loan Officer A receives commission of 1% per loan and Loan Officer B receives commission of 1.25% per loan.
- Permissible or not?
- Permissible. Fed rule does not require that all loan originators receive same compensation, as long as no loan originator's compensation varies based on the loan terms.

- Example 17b (Wholesale—Loan Terms).
- Mortgage company enters into commission agreements with mortgage brokers. Mortgage Broker A receives commission of 2% per loan and Mortgage Broker B receives commission of 2.5% per loan.
- Permissible or not?
- Permissible. Fed rule does not require that all loan originators receive same compensation, as long as no loan originator's compensation varies based on loan terms.

- Example 18 (Retail—Loan Terms).
- Mortgage company enters into agreements with branch manager employees to pay compensation based on branch profits. Managers do not arrange, negotiate or otherwise obtain extensions of credit for consumers, and their compensation is not based on whether any particular loan is originated.
- Permissible or not?
- Permissible. Such employees qualify for manager and administrative staff exception and, as a result, the employee managers are not subject to the restriction of compensation based on loan terms.

- Example 19 (Retail—Loan Terms).
- Mortgage company enters into agreements with branch manager employees to pay compensation based on branch profits. Managers both manage and also originate loans.
- Permissible or not?
- Risky business.
- Fed informally advised that if manager also originates, then all compensation received by manager is subject to the rule, even compensation received in the capacity as a manager.
- With regard to compensation based on profits, Fed informally expressed concern. Profits generally will be higher if higher rates and fees charged for loans. No safe harbor under rule for conditioning additional compensation on profit trigger.

- Example 20 (Retail—Loan Terms).
- Mortgage company enters into agreements with branch managers to pay compensation. Branch managers receive fixed number of basis points for each loan originated by branch.
- Permissible or not?
- Permissible. In addition to managerial exemption, compensation may be paid based on fixed percentage of loan amount.

- Example 21 (Retail—Loan Terms).
- Mortgage company selects certain loan officers and establishes “net branch” consisting of the loan officers. Loan officers receive compensation based on profits of “net branch.”
- Permissible or not?
- Risky business.
- With regard to compensation based on profits, Fed informally expressed concern. Profits generally will be higher if higher rates and fees charged for loans. No safe harbor under rule for conditioning additional compensation on profit trigger.
- Fed also informally noted that allowing this structure essentially would permit “net branches” consisting of individual loan officers.

- Example 22 (Wholesale—Dual Compensation).
- For arranging mortgage loan, mortgage broker will receive \$1,000 from consumer and \$1,500 from creditor.
- Permissible or not?
- Not permissible. Loan originator may not receive compensation from both consumer and creditor.

- Example 23 (Wholesale—Dual Compensation).
- For arranging mortgage loan, mortgage broker will receive \$1,000 out of loan proceeds and \$1,000 directly from consumer, and no other compensation.
- Permissible or not?
- Permissible. Payments to loan originator out of loan proceeds are considered to be compensation received directly from consumer. So loan originator may receive both payments, because only consumer is compensating loan originator.

- Example 24 (Wholesale—Dual Compensation).
- For arranging mortgage loan, mortgage broker will receive \$1,000 out of premium interest rate and \$1,000 directly from consumer. Note, broker's compensation is not based on interest rate—premium rate was used to pay various closing costs, including part of broker's compensation.
- Permissible or not?
- Not permissible. Payments to loan originator out of interest rate are not considered to be compensation received directly from consumer. So loan originator may not receive payment out of interest rate and payment from consumer.

- Example 25 (Wholesale—Dual Compensation).
- With a brokered loan, the consumer will pay 1 point to the creditor and will directly pay a 1% origination fee to the mortgage broker. The creditor will remit the point paid by the consumer to the broker.
- Permissible or not?
- Not permissible. Payments to loan originator from creditor out of points paid by the consumer, whether in cash or out of the loan proceeds, are not considered to be compensation received directly from consumer. In this situation, creditor is considered to pay point to broker even though consumer funded the point. Thus, broker may not receive both a point from creditor and an origination fee from consumer.

- Example 26 (Wholesale—Steering).
- Mortgage broker finds exact same loan with exact same terms and conditions from Creditor A and Creditor B. These are best available loans and consumer qualifies for loans. Creditor B pays higher compensation and broker steers consumer to Creditor B.
- Permissible or not?
- Permissible. The steering prohibition is not violated when mortgage originator directs consumer to loan that will result in greater compensation to originator if terms and conditions on that loan compared to other possible loan offers available through originator, and for which consumer qualifies, are same.

- Example 27 (Wholesale—Steering).
- Consumer qualifies for loan from Creditor A with 7.0% rate and loan from Creditor B with 7.5% rate. Mortgage broker steers consumer to loan with Creditor B. Creditor B pays more compensation to broker than available through Creditor A
- Permissible or not?
- It depends.
- If the loan from Creditor B is in consumer's interest, this is permissible. In this situation, Fed indicates that loan from Creditor B may be in consumer's interest if, for example, loan from Creditor A has prepayment penalty or requires consumer to pay more upfront charges than consumer is able or willing to pay.

Thank you.

Questions?