



Federal Reserve Board
Final Rule on Loan Originator Compensation was issued
August 16, 2010

Effective Date: April 1, 2011



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YOU SHOULD NOT RELY ON IT TO COMPLY
WITH THE FEDERAL RESERVE BOARD'S RULE
ON COMPENSATION

PLEASE CONSULT AN ATTORNEY

Outline of this Document

- I. What are the problems with the rule?
- II. NAMB Plan of Action
- III. Overview of the Rule
- IV. General Rules
- V. Steering and the Safe Harbor
- V. Dual Compensation
- VI. Incentive Compensation
- VII. Market Distortions and Competitive Issues
- VIII. Regulatory Time-line for Dodd-Frank



- Nomenclature of this document:
- The Federal Reserve Board (FRB) considers Mortgage Broker Companies (MBC) as the same as Loan Originators (LO's) working for the MBC.
- Lender Companies (LC's) in this document reference Federally-chartered and State-chartered banks and also Lender Corporations.
- NOTE: the FRB has determined LC's that table fund or broker a loan are considered MBC/LO's for purposes of this LO Comp Rule.
- Most examples in this document come from the staff commentary to the FRB LO Comp Rule.



I. What are the problems with the Rule?

I. MBC/LO Cannot lower their price to compete

- 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.
- Not permissible. While pricing to consumer may be adjusted by the lender, compensation to loan originator may not increase or decrease based on loan pricing. Broker Companies and their LO's cannot lower their price to meet competition.

I. The Market Will Use Mortgage Brokers or Will They?

- NAMB continues to review the Federal Reserve Board's final rule and is collecting questions on how lenders will operationalize the rule.
- The Mortgage Broker business model is still a sound business model. However, we see serious competitive issues.
- Mortgage Brokers are able to receive indirect compensation from the creditor by increasing the par rate of the loan.
- Brokers can get direct compensation from consumers. (Note: the FRB has said the GFE credit to borrower is not from the consumer it is from the investor)

I. Problems/Questions

- We have concerns about how a MB can compete with a creditor on where the creditor offers 1% fee from the consumer and there is a 1% fee in the rate (backend).
- No compensation payments may vary for 30 yr fixed vs ARM vs. Interest only.
- Mortgage Brokers cannot lower their commission to get the deal done!
- Lender/Bank must lower their profit to get the deal done.

I. Problems/ Questions

- Is this too complex for lenders to comply?
- Will this complexity kill the Mortgage Broker channel?
- Is there a basis to stop this rule?
- When are they going to merge it with the GFE disclosure so these disclosures work together?
- How does 1032(f) of the Dodd Frank Act affect this rule?

I. What are the issues?

- Pricing discretion has been taken away from the mortgage broker and loan originator. (no up-selling) nor price concessions to win business (you cannot lower your commission)
- Mortgage Broker company is treated like a loan originator.
- Use SAFE Act definition
- The rule is too complex to comply with.
- Did the Federal Reserve Board did not follow the Reg Flex Act?

II. NAMMB Plan of Action

II. NAMB Plan of Action

- NAMB has decided to take three courses of action.
 - We will attempt to help members, wholesalers, and investors determine how to comply with the rule.
 - We will attempt to delay the rule through Congressional action and legal action.
 - We will attempt to legally challenge the rule in court if financially feasible.
- NAMB Believes the rule is harmful to consumers and to competition.

II. NAMB Plan of Action

- Make contact with Senate and House members.
- Delay the April 1st Effective date 12 months
- Legislative Changes
- Legal Action

III. Overview

III. Effective Date and Document Retention Rules

- ✓ 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.
- ✓ Rule requires creditors and other parties who compensate loan originators to retain records for at least two years after consummation of transaction.

III. Loan Term/Condition Prohibition

Compensation includes amounts retained by loan originator, not bona fide and reasonable charges of third parties that are not retained.

III. Who Does this Apply to?

The 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.

1. Includes creditor employees who meet definition, mortgage broker employees who meet definition, and mortgage broker companies.
2. 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.
3. Includes individuals and entities. It does not follow the definition of Originator found in the SAFE ACT.

III. Who is a Loan Originator

- Mortgage Broker (MB) companies
- Loan Originators that work for a MB, Lender, Bank, or any creditor.
- A creditor that uses Table Funding is a Loan Originator (LO).

An entity using a *bona fide* warehouse line of credit is not a Loan Originator *

* Note the new Request for comments from HUD on the secondary market exemption.

III. Who is not Covered

- 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.
- Problem here for managers who manage an office and also take loans. They cannot get paid on loan production. Exception is if they are an owner and have capital at risk.

III. Other Issues

- Please do not confuse the TILA rules (this FED rule) with the rules for the GFE from HUD. (credit to the borrower, etc.)
- These laws are separate and distinct.
- The TILA and GFE disclosures will be merging soon. Treasury/CFPB will be working on a merged disclosure. NAMB will be at the table representing mortgage brokers.

III. Exclusions and Anomalies

- Payments to creditors for selling loans to secondary market investors.
- Payments from investors to creditors in connection with origination of a loan (including incentive compensation for delivering certain types of loans), when the creditors fund out of their own resources or use a bona fide warehouse line (but not those using table funding). This is the exact types of payments the FRB has called unfair and deceptive and could be a legal issue.
- Loan servicers when they modify existing loan on behalf of current owner of loan.

IV. General Rule

IV. The General Rule

- 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 and deceptive trade practice authority. Legal problem is incentive payments remain permissible to creditors from secondary market. FRB will have to explain this anomaly.
- 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 (no dual compensation)
 - Steering based on ability of loan originator to receive greater compensation.
- Rule finalizes earlier Fed proposal.

IV. The General Rule

Loan Term/Condition Prohibition

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 the transactions' terms or conditions.

- Compensation includes amounts retained by loan originator, not bona fide and reasonable charges of third parties that are not retained.

IV. General Rules

- MBC may pay their LO's a percentage of profits. Payments for particular loans cannot vary.
- LO's may own a percentage of the MB and receive payments of their share of profits based on ownership.
- A creditor may pay a MBC for performance of the loan after the loan is closed (example: payment for 6 months of loan performance).

IV. What is not “term and condition”

- Not T & C
 - Volume
 - Hourly pay to LO's
 - Fixed dollar amount for each loan
 - Set percentage on all loans based on amount borrowed
 - Quality of the loan file sent by the LO
 - Pull through rates and post closing performance
 - Example: Car lease payments if some metric of performance of the loan or number of loans closed.

V. Steering Prohibition

V. No Steering

- Steering is it is not allowed. Meaning a creditor cannot pay you more for bringing them a particular type of loan or a loan with particular conditions.

V. No Steering but a Safe Harbor

However, there is a safe harbor

- The consumer is presented with loan offers for each type of transaction in which the consumer expresses an interest (that is, a fixed rate loan, adjustable rate loan, or a reverse mortgage); and
 - The loan options presented to the consumer include the following:
 - the lowest interest rate for which the consumer qualifies;
 - the lowest points and origination fees, and
 - the lowest rate for which the consumer qualifies for a loan with no risky features, such as a prepayment penalty, negative amortization, or a balloon payment in the first seven years.

V. 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.*
 - * *But if you only regularly do business with less than three creditors, this is satisfied if options are obtained from all creditors with whom you do business.*
- *Consumer does not have to be presented with all loan options that originator obtains, as long as option presentation element is satisfied.*
- *Do you have to run the consumer through the AU systems or just how far do you have to take the borrower? Loan originator must believe in good faith that consumer likely qualifies for options presented.*

V. Steering Example 1.

- Consumer qualifies for loan from Creditor A with 7.0% rate and loan from Creditor B with 7.5% rate. Mortgage broker explains to a consumer the attributes of a loan with Creditor A vs Creditor B (price is not the only consideration). Creditor B pays more compensation to broker than available through Creditor A
- In some cases permissible. If the loan from Creditor B is in the consumer's interest (here is where the lawyers make money). 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.

V. Steering Example 2. (same as last question)

- Consumer qualifies for loan from Creditor A with 7.0% rate and loan from Creditor B with 7.5% rate. Mortgage broker explains to a consumer the attributes of a loan with Creditor A vs Creditor B (price is not the only consideration). Creditor B pays more compensation to broker than available through Creditor A
- In some cases permissible. If the loan from Creditor B is in the consumer's interest (here is where the lawyers make money). For example, Creditor A closes on time 5% of the time and closing on time is important to the consumer.

V. Steering Example 3.

- 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 explains to the consumer the attributes of loan from Creditor A and Creditor B.
- **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.

V. The Safe Harbor that is not safe.

- Show the consumer more than four loan options could confuse the consumer (the FRB believes)
- What is the consumer's best interest and who gets to decide that?
- Not defined by FRB.
- How will a court decide that?
- What if you tell the consumer about the probability of closing on time for each lender?

VI. Dual Compensation

How Can a MBC/LO Get Paid? (one source of compensation)

- If a mortgage broker gets paid by the consumer, you cannot get paid by any other person (employer or creditor).
- If you get paid by the creditor, you cannot get paid by the consumer.
- Cannot get paid based on terms and conditions of the loan
- A creditor can pay a mortgage originator a set percentage of the borrowed amount...but not a percent that varies with loan amount.
- \$300k = 1.5%
- \$200k = 2%
- \$100k = 3%

Dual Comp. Example 1: GFE Credit to the Borrower is deemed coming from the lender not consumer.

- Consumer quoted 5% rate with 1 origination point and consumer will pay all fees.
- To meet competition, loan originator will receive standard compensation of 3% from creditor, but will pay fees of the consumer, either directly or through a credit, up to 0.5% of the loan amount.
- **Not permissible.** Fed believe that it views this to be the same as a pricing concession which are not allowed.

Dual Comp Example 2: Consumer may switch from paying commission all up front to all in the rate

- 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.** 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.

Dual Comp Example 3: MBC/LO at a disadvantage

- MBC/LO transaction, the consumer will pay 1 point to the creditor and will directly pay a 1% origination fee to the MBC . The creditor will remit the point paid by the consumer to the MBC.
- **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, MBC/LO may not receive both a point from creditor and an origination fee from consumer.

Dual Comp Example 4: MBC/LO at a disadvantage

- For arranging mortgage loan, MBC will receive \$1,000 out of higher rate and \$1,000 commission directly from the borrower. MBC compensation is not based on interest rate. The increase in rate over Par was used to pay commission to MBC and borrower closing costs.
- **Not permissible.** Payments to loan originator out of interest rate are not considered to be compensation received directly from consumer. So MBC/LO may not receive payment out of interest rate and payment from consumer. So even if the rate increase was for 3rd party fees and MBC commission, it is not permissible. Banks and lenders may offer this type of product.

Dual Comp. Example 5: Loan Proceeds and directly from consumer

- For arranging mortgage loan, MBC/LO will receive \$1,000 out of loan proceeds and \$1,000 directly from consumer, and no other compensation.
- **Permissible.** Payments to loan originator out of loan proceeds are considered to be compensation received directly from consumer. So MBC/LO may receive both payments, because only consumer is compensating loan originator.

Dual Comp. Example 6: Cannot get paid from borrower and creditor

- For arranging mortgage loan, MBC/LO will receive \$1,000 from consumer and \$1,500 from creditor.
- **Not permissible.** Loan originator may not receive compensation from both consumer and creditor.
- * Bank and lenders will be permitted to offer this type of transaction.

VII. Incentive Compensation

VII. Incentive Compensation Violates Terms and conditions Rule

- Mortgage broker with highest average interest rate and discount point combination each month receives a gift. Mortgage company offers incentive promotion to mortgage brokers.
- **Not permissible.** Compensation includes:
 - Commissions and any financial or similar incentive.
 - Annual or other periodic bonus.
 - Awards of merchandise, services, trips or similar prizes.

Incentive Example 1: Gift Incentives ok but watch out for RESPA

- Mortgage company offers incentive promotion to mortgage brokers.
- Mortgage broker with highest dollar amount of originations each month receives gift or trip.
- **Permissible but RESPA issues.** Trip or gift is compensation, but compensation can be based on volume of loans, by dollar or number, in given period. Watch out for violations of RESPA Section 8.
- Re: 1032(f) of Dodd-Frank. Why didn't FRB and HUD fix this?

Incentive Example 2: Again, Incentive for loan volume is ok, but watch out for RESPA

- Mortgage company offers bonus compensation to mortgage brokers companies.
- Mortgage broker companies and LO's qualify for additional compensation if they originate certain number or dollar volume of loans each quarter.
- **Permissible.** Compensation can be based on volume of loans, by dollar or number, in given period. But be mindful of RESPA Section 8.

Incentive Example 3: RESPA Again conflicts with FRB Comp Rule

- Mortgage lender company offers bonus compensation to mortgage broker company.
- Mortgage broker company qualifies for additional compensation if it originates a certain number or dollar volume of loans each quarter.
 - * Bonus payments conditioned on mortgage lender company achieving certain overall level profit during each quarter (not tied to individual loan terms) in its wholesale operations.
- Unknown. 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.

Incentive Example 4: Lower loan amounts will suffer. MBC/LO cannot get paid a variable commission

- If a mortgage broker gets paid by the consumer, you cannot get paid by any other person (employer or creditor).
- If you get paid by the creditor, you cannot get paid by the consumer.
- Cannot get paid based on terms and conditions of the loan.
- A creditor may pay a MBC/LO a set percentage of the borrowed amount...but not a percent that varies with loan amount.
- \$300k = 1.5%
- \$200k = 2%
- \$100k = 3%

Incentive Example 5: MBC/LO Company may be paid commission in a set range

- Mortgage Lender company will pay MBC/LO 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.** 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.

IX. Regulatory Timeline for Dodd-Frank

IX. Timeline

An Implementation Timeline for Key Wall Street Reform Act Provisions (2010)

The Dodd-Frank Wall Street Reform Act was signed into law on July 21, 2010, but the actual implementation of its new requirements will be staggered over the next 2 1/2 years. Below, we highlight the "key dates" over the next 2 1/2 years for those provisions that most affect mortgage professionals.

IX. Timeline

October 19, 2010: Deadline for Federal Reserve Board to prescribe interim final regulations defining acts or practices that violate appraisal independence.

March 21, 2011: Deadline for the federal banking agencies, SEC, HUD, and the FHFA to issue final rules under the Act's “skin in the game” risk retention provisions, which require companies that sell mortgage backed securities to retain at least 5% of the credit risk unless the underlying loan is a “qualified mortgage” meeting standards set forth in this regulation.

April 1, 2010: Effective date of the 2010 Federal Reserve Board final regulation on mortgage loan origination, that (1) prohibits payments to loan originators based on the terms or conditions of the transaction; (2) prohibits any person other than the consumer from paying compensation to a loan originator in a transaction where the consumer pays the loan originator directly; and (3) prohibits loan originators from steering consumers to consummate a loan not in their interest based on the fact that the loan originator will receive greater compensation for such loan.

IX. Timeline

July 21, 2011: The “Transfer Date”: when regulatory and enforcement authority under the following federal consumer protection laws will be transferred to the new Consumer Financial Protection Bureau (Bureau).

- Real Estate Settlement Procedures Act (RESPA)
- Truth in Lending Act (TILA)
- Alternative Mortgage Transaction Parity Act
- Consumer Leasing Act
- Electronic Fund Transfer Act
- Equal Credit Opportunity Act
- Fair Credit Billing Act
- Fair Credit Reporting Act
- Home Owners Protection Act
- Fair Debt Collection Practices Act
- Home Mortgage Disclosure Act (HMDA)
- Home Ownership and Equity Protection Act (HOEPA)
- Truth in Savings Act
- S.A.F.E. Mortgage Licensing Act

IX. Timeline

July 21, 2011: Effective date of the new preemption standards for national banks and federal savings associations (Sections 1044-1048). banks and federal savings associations (Sections 1044-1048).

July 21, 2011: Ending date for federal preemption for operating subsidiaries of national banks and federal savings associations (including joint ventures of operating subsidiaries) (Sections 1044-1048).

IX. Timeline

October 21, 2011: Deadline for all staff currently handling regulatory and enforcement responsibilities under the above federal consumer protection laws to physically move from their current agency to the Bureau.

March 21, 2012: Outside effective date for the new “skin in the game” requirements (one year after the publication of final regulations).

July 21, 2012: Deadline for the Bureau to propose a rule creating a single, integrated, RESPA-TILA disclosure (Section 1032(f)).

January 21, 2013: Deadline for the Bureau to issue final regulations under the Act’s new requirement for mortgage lenders to determine a borrower’s “ability to repay” the mortgage loan.

IX Timeline

January 21, 2013: Deadline for the Bureau to issue final rules that prohibit or condition terms, acts or practices relating to mortgages that “it finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available” (Section 1405).

January 21, 2013: Deadline for the Bureau and federal banking agencies to finalize joint rules related to appraisal management companies that will (1) establish minimum requirements for state registration and supervision of appraisal management companies (except for financial institution subsidiaries); (2) establish the framework for a federal registry for appraisal management companies; and (3) establish quality control standards for automated valuation models.

IX. Timeline

January 21, 2014: Outside effective date for the new “ability to repay” standards (one year after the publication of final regulations) Section 1411).

January 21, 2014: Likely effective date for rules that prohibit or condition terms, acts or practices relating to mortgages that “it finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available” (one year after the publication of final regulations) (Section 1405).

January 21, 2014: Likely effective date for rules that will (1) establish minimum requirements for state registration and supervision of appraisal management companies (except for financial institution subsidiaries); (2) establish the framework for a federal registry for appraisal management companies; and (3) establish quality control standards for automated valuation models (one year after the publication of final regulations).

We will fight for

- We continue to believe the MB company should not be treated the same as the LO.
- We are concerned the FED's compensation model interferes with small business to the benefit of large national banks.
- We are concerned about the impact of this rule on wholesale lenders and will fight to protect them.
- The GFE credit to the borrower should be deemed cash directly from the consumer. (because it is!)



Questions