Division of Depositor and Consumer Protection - Kansas City Region

Regional Banker Call
June 17, 2011

Truth in Lending – Mortgage Loan Originator Compensation Rules

Presenters: Tony Sinopole
Sara Erickson
Nichol Harris

Presentation Information

- Presentation PowerPoint: http://www.fdic.gov/news/conferences/kc_region/2011-06-17.html
- Common questions
- Fifteen minute break
- Email address for questions: kcconferencecall@fdic.gov

Objectives

- Understand the three aspects of the mortgage loan originator compensation rule and how they impact your bank:
  - Prohibition on compensation based on loan terms or conditions
  - Prohibition on dual compensation
  - Prohibition on steering

Background

- Amends Regulation Z
- Intended to protect consumers from unfairness, deception, and abuse
- Over 6000 comments received

Effective Date

226.36 - 2 Official Staff Interpretations

- Effective for all loan applications received on or after April 6, 2011.

Loan Originator Definition

226.36(a)(1)

- A person who for <u>compensation or other monetary gain</u>, or in expectation of compensation or other monetary gain, <u>arranges, negotiates, or otherwise obtains</u> an extension of credit for another person

Loan Originator includes…

226.36(a)(1)

- Includes:
  - Individual
  - Entity
  - Employee
  - Employer

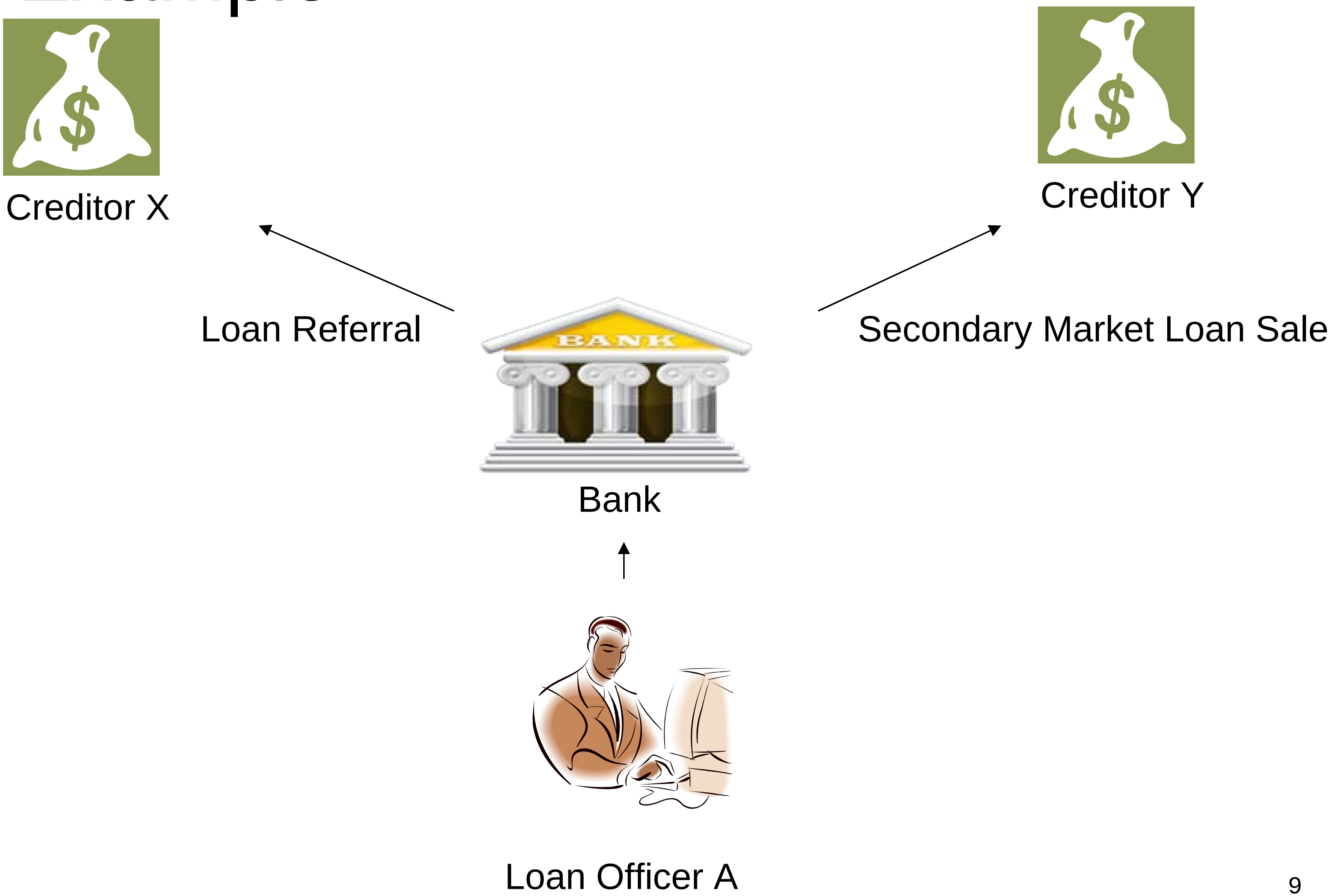
- Examples:
  - Mortgage brokers
  - Employees of mortgage brokers
  - Employees of creditor (i.e., loan officers, producing managers)
  - Creditors in table-funded transactions
  - Broker in a referral arrangement

Exemptions

226.36(a)(1)

- Non-Producing Managers and Administrative Staff are exempt
- Creditors are exempt if:
  - Fund the loan from their own resources
- Loan Servicers are exempt if:
  - Only modify an existing loan, and the modification does not constitute a refinancing under Regulation Z

Example


Creditor X
Creditor Y
Loan Referral
BANK
Bank
Secondary Market Loan Sale
Loan Officer A

What is Compensation?

226.36(d)(1)-1.i Official Staff Interpretations

- Compensation includes:
  - Salaries
  - Commissions
  - “Processing fee” assessed by loan originator
  - Any financial or similar incentive

- For example:
  - Annual or other periodic bonus
  - Awards of merchandise, services, trips, or similar prizes

Not Compensation

226.36(d)(1)-1.iii Official Staff Interpretations

- Amounts for third party charges are not considered compensation if bona fide and reasonable
  - The amount received for payment may even exceed the amount for the actual charge if the charge (i) was bona fide and reasonable, and (ii) complied with state or other applicable law

When Does This Apply

226.36-1Official Staff Interpretations

- To consumer credit transactions that are secured by a dwelling, other than open-end credit plans and time shares
  - This includes:
    - First lien
    - Subordinate lien

Payments Based on Terms or Conditions

226.36(d)(1)

- Loan originator shall not receive and no person shall pay to a loan originator compensation in an amount that is based on any of the transaction's terms or conditions

Terms or Conditions

226.36(d)(1)-2 Official Staff Interpretations

- Term or condition based compensation includes compensation based on a loan’s:
  - Interest rate
  - APR
  - Loan-to-value ratio
  - Existence of a prepayment penalty
  - Proxy for terms and conditions
    - DTI, credit score, or other risk factors

Not Based on Terms or Conditions

226.36(d)(1)-3 Official Staff Interpretations

- Compensation not based on the loan terms or conditions include:
  - Overall loan volume
  - Long-term performance
  - Hourly rate
  - Existing customer or a new customer
  - Fixed payment for each loan
  - Percentage of applications that resulted in consummated transactions
  - Quality of loan files
  - Legitimate business expense such as fixed overhead costs
  - Based on amount of credit extended, if fixed amount

Amount of Credit Extended

226.36(d)(1)(ii)

- The amount of credit extended is <u>not</u> deemed to be a transaction term or condition, provided compensation is based on a <u>fixed</u> percentage of the amount of credit extended; however, such compensation may be subject to a minimum or maximum dollar amount
  - May not vary with levels or tiers of loan amount

Creditor Flexibility

226.36(d)(1)-4 Official Staff Interpretations

- A creditor may charge a higher interest rate to a consumer who will pay fewer of the costs of the transaction directly, or it may offer the consumer a lower rate if the consumer pays more of the costs directly
  - As long as compensation is not based on loan terms or conditions

Compensation Received Directly From Consumer

226.36(d)(1)-7 Official Staff Interpretations

- The prohibition in (d)(1) does not apply if the compensation is received <u>directly</u> from the consumer
  - in this situation (d)(2) would apply

Compensation

226.36(d)(1)-7 Official Staff Interpretations

- Payments directly from Consumer:
  - Payments to loan originator out of loan proceeds
  - Amounts retained by loan originator (excluding bona fide and reasonable third-party charges)
  - Seller Contributions

Payments by Persons Other than Consumer (Dual Compensation)

226.36(d)(2)

- If loan originator received compensation directly from a consumer:
  i. Loan originator can not receive compensation, directly or indirectly, from any other person
  ii. If person knows or has reason to know of the consumer-paid compensation, then the person shall not pay any compensation to a loan originator

Compensation in Connection with a Particular Transaction

226.36(d)(2)-1 Official Staff Interpretations

- This section relates only to payments that are specific to, and paid solely in connection with, the transaction in which the consumer has paid compensation directly to a loan originator (e.g. commissions)

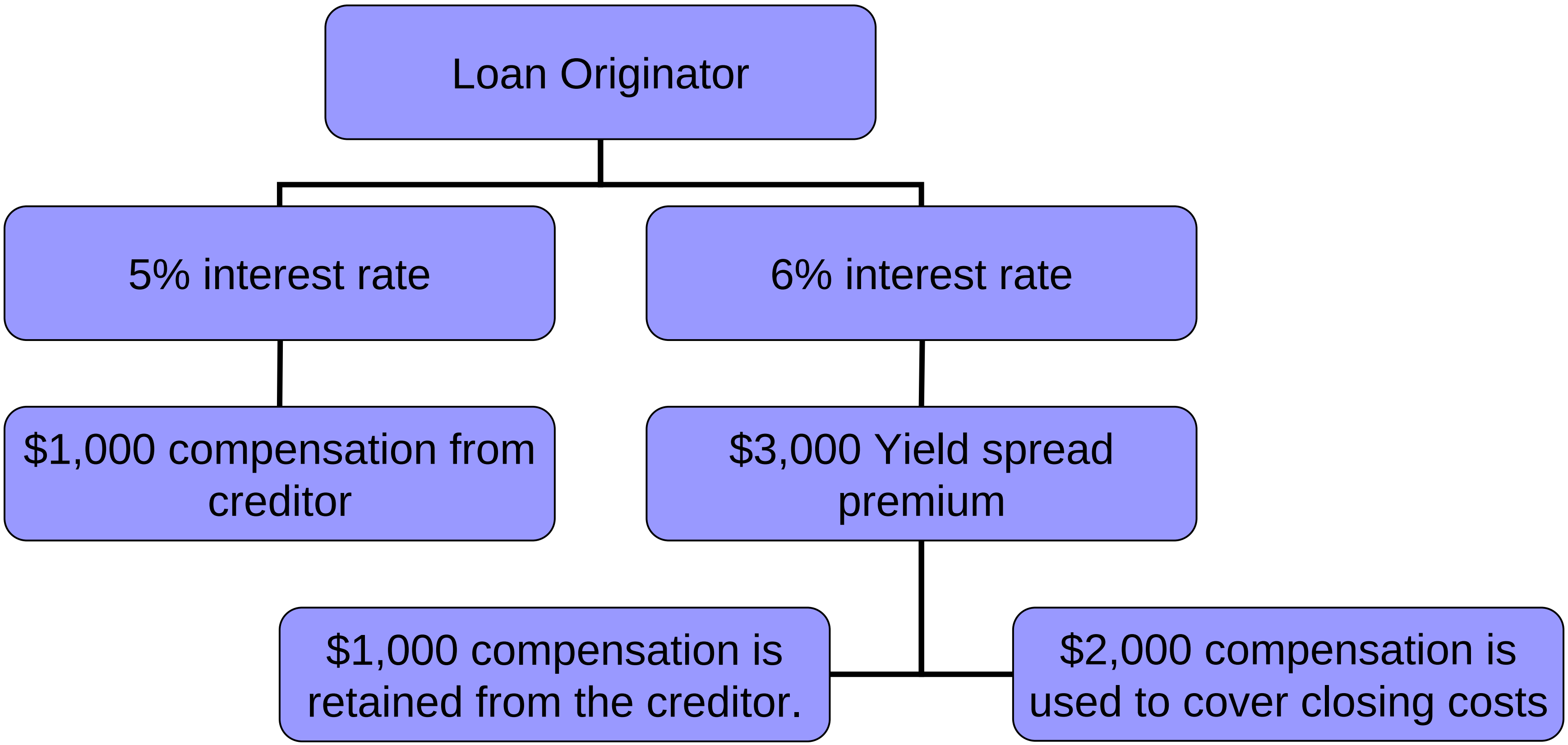
Yield Spread Premiums

Federal Register page 58511

- Definition: Yield spread premium is the present dollar value of the difference between the lowest interest rate the wholesale lender would have accepted on a particular transaction and the interest rate the broker actually obtained for the lender

Yield Spread Premium Example

Federal Register page 58525



Yield Spread Premiums

226.36(d)(2)-2 Official Staff Interpretations

- Yield spread premium paid by a creditor to the loan originator may be characterized on RESPA disclosures as a “credit” that will reduce consumer’s settlement charges.

Affiliates

226.36(d)(3) and Official Staff Interpretations 226.36(d)(3)-1

- Affiliates shall be treated as a single "person"
- Affiliate is defined for this purpose to mean any company that controls, is controlled by, or is under common control with another company. (*See,* the Bank Holding Company Act)

Steering

226.36(e)(1)-1 Official Staff Interpretations

- Advising, counseling, or otherwise influencing a consumer to accept a particular transaction

Prohibition on Steering
226.36(e)(1)

- A loan originator shall not direct or “steer” a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the loan originator offered or could have offered, unless the consummated transaction is in the consumer’s interest

Steering – Safe Harbor

226.36(e)(2) and (e)(3)

- **To come within the steering safe harbor, the loan originator must**:
  - Present the consumer with loan options for each type of transaction in which the consumer has expressed an interest,
  - Obtain the loan options from a significant number of creditors with which the originator regularly does business, and
  - Have a good faith belief that the loan options presented are loans for which the consumer likely qualifies.

Steering - Safe Harbor

226.36(e)(2)

- Type of transaction refers to whether:
  - A loan has annual percentage rate that cannot increase after consummation (Fixed)
  - A loan has an annual percentage rate that may increase after consummation (Variable)
  - A loan is a reverse mortgage

Steering – Safe Harbor

226.36(e)(3)(i)

Loans options must include the loan with:

a) the lowest interest rate
b) the lowest interest rate without risky features
c) the lowest total dollar amount for origination points/fees and discount points

Steering - Safe Harbor

226.36(e)(3)-1 & 2 Official Staff Interpretations

- Must obtain loan options:
  - from a <u>significant number of creditors</u>
    - Three
  - with which the loan originator <u>regularly does business</u>
    - Written agreement
    - One loan in the past month, or
    - 25 loans in the past year

Steering - Safe Harbor

226.36(e)(3)

- Must have a good faith belief that options presented are loans for which the consumer likely qualifies (based on available information)

- Must highlight the loans that satisfy the criteria of the safe harbor if providing more than 3 options

Steering

- Steering may not be a concern:
  - If a creditor does not have multiple referral arrangements
  - If a loan originator receives the same compensation on all loan programs
  - If a loan originator directs the consumer to the loan with the least amount of creditor-paid compensation
  - If a creditor only offers in-house products and is not violating (d)(1)

How Will This Affect My Bank?

- Determine who are the loan originators and how is compensation paid
- If consumer is paying compensation directly to loan originator, you must review dual compensation prohibition
- If the loan originator compensation would differ between transactions, you must also review steering prohibition
- Review compensation agreements

Review

- Prohibited from paying compensation based on loan terms or conditions
- Prohibited from dual compensation
- Prohibited from steering a consumer to a loan that provides greater compensation unless the loan is in the consumer’s interest

Questions & Answers

1. **Is it permissible to compensate a loan originator based on the long-term performance of the loans she or he originates? For example, can the creditor take back some of the loan originator's compensation based on the amount of early payment defaults?**

2. **May the amount of compensation differ among loan originators?**

3. **Can the compensation vary based on loan type, such as, purchase versus refinance?**

Questions & Answers

4. **Can an incentive compensation plan for a loan originator based on loan volume provide for different percentage amounts based on the aggregate dollar volume of the loan originator's loans over a particular period?**

5. **Can compensation based on profits be paid to a loan originator?**

6. **How do 401K profit sharing plans fall into this rule? Are mortgage loan originators no longer allowed to participate in these types of plans?**

Questions & Answers

7. **Can compensation based on profits be paid to a manager or other employee who is not a loan originator?**

8. **Are managers, administrative staff and similar individuals considered loan originators?**

9. **Loan originators will receive $300 for every loan originated and an extra $100 if loan has a prepayment penalty. Is this compliant with new rule?**

Questions & Answers

10. **Can you take back compensation based on disclosure errors, such as errors in the Good Faith Estimate or HUD settlement statement?**

11. **If a loan originator lowers the interest rate or lowers fees to match competition, can you lower the loan originator’s compensation?**

12. **Can the transactions that a manager originates be segregated from those that he or she does not originate for compensation purposes?**

Questions & Answers

13. **Can broker compensation be reduced to avoid a higher priced loan or high cost loan?**

14. **Can the broker provide a credit to cure RESPA violations for understating estimates of settlement service fees beyond the allowed tolerances?**

15. **Is the dual compensation provision a concern if the consumer pays the broker compensation, then the creditor pays third party charges for the consumer?**

Questions & Answers

16. **If the loan is going to be originated in house and the bank employee does not earn compensation based on terms or conditions of a loan, does the bank have to follow the anti-steering provision by providing a disclosure to the consumer?**

17. **Can the bank earn compensation from a sale to the secondary market if the bank also charged an origination fee directly to the consumer?**

18. **Can a creditor offer different consumers varying interest rates that include a constant interest rate premium to recoup the loan originator's compensation through an increased interest rate paid by the consumer (such as by adding a constant 0.25 percent to the interest rate on each loan)?**

Links/Resources

- Federal Register
  - http://edocket.access.gpo.gov/2010/pdf/2010-22161.pdf
- Federal Reserve Consumer Compliance Outlook Webinar
  - http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live/2011/loan-originator-compensation.cfm
- RESPA ROUNDUP
  - http://www.hud.gov/offices/hsg/rmra/res/mlocomplrodup31811v3.pdf
- Mortgage Loan Originator Call Email
  - kcconferencecall@FDIC.gov
- Contact your local FDIC Field Office for help

Thank you