Regulation Z—Loan Originator Compensation

Outlook Live Webinar – March 17, 2011

Board of Governors of the Federal Reserve System

Division of Consumer and Community Affairs

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Overview

- Final rule, published September 24, 2010, protects consumers from unfair, abusive, or deceptive practices that can arise from loan originator compensation arrangements.
- Effective April 1, 2011.
- Main provisions address:
  - Payments by creditors and other persons to loan originators,
  - Payments by consumers to loan originators, and
  - "Steering" by loan originators.

Overview *(continued)*

- Rules regulate compensation of loan originators on covered transactions.
- Loan originator: Person 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:
  - Mortgage brokers, both companies and their employees who engage in originations (loan officers);
  - Loan officers employed by creditors.
- Covered transactions: Closed-end consumer credit transaction secured by a dwelling.

Overview *(continued)*

- Prohibits compensation to a loan originator, paid by any person other than consumer, that is based on loan's terms or conditions.
  - Amount of credit extended (loan amount) is not deemed to be a term or condition provided it's a fixed percentage (may have floors/ceilings).

- Terms or conditions include: Interest rate, APR, LTV, PPP.

- Terms or conditions do not include: overall loan volume, long-term loan performance, hourly basis, existing/new customer, flat fee, "pull-through" rate, quality of loan files, legitimate business expense.

Overview *(continued)*

- Prohibits loan originators from receiving compensation directly from consumer while also receiving compensation on same loan from any other person.

- Payments from loan proceeds are considered payments made directly by consumer.

- YSP disclosed as a “credit” under RESPA are <u>not</u> considered payments made directly by consumer.

Overview *(continued)*

- Prohibits loan originators from “steering” consumers to a lender to receive greater compensation, unless loan is in consumer’s interest.
- Safe harbor—loan originator complies if:
  - Consumer is presented with loan options for each type of loan in which consumer expresses an interest (FRM, ARM, reverse) that include at least:
    - Lowest interest rate;
    - Lowest interest rate without certain risky features; and
    - Lowest total for origination and discount; and
  - Originator:
    - Obtains options from a significant number of creditors with which originator regularly does business; and
    - Believes in good faith that consumer likely qualifies for the options presented.

Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act:

- Also restricts loan originator compensation practices.
- Includes provisions similar to—substantially codifies—Board's rules.
- But also includes additional provisions addressing practices not covered by the Board's rules.
  - Will require further rulemaking in the future.

Questions

Meaning of “Loan Originator”—226.36(a)

- “Arranges, negotiates, or otherwise obtains”
  - Referrals
- Managers and administrative staff
  - “Producing managers”
  - Bifurcated manager compensation
  - Loan processors
  - Routine interaction with consumer
- “Table-funded” creditor (but still creditor for disclosure purposes)

Questions *(continued)*

Transactions covered—consumer credit transaction secured by a dwelling

- "Dwelling"—*see* 226.2(a)(19).
  - Can include mobile homes, trailers, houseboats—anything "in fact used as residences." Comment 2(a)(19)-2.
- Second homes vs. investment or rental properties
- Construction loans

Questions *(continued)*

Compensation Based on Terms or Conditions—226.36(d)(1)

- Loan product type, purpose, etc.
  - FHA vs. conventional
  - Purchase money vs. refinancing
  - Vacation home vs. principal dwelling
  - Brokered out vs. kept in-house
  - Construction vs. permanent financing
  - Brokered to Lender A vs. Brokered to Lender B
  - State HFA loans vs. “standard” market loans
- “Proxies”—comment 36(d)(1)-2

Questions *(continued)*

Compensation Based on Terms or Conditions
(continued)

- Compensation variations relating to operating costs
  - Reimbursement to originators for business expenses
  - Charges to originators for support services, e.g., "lead generation"

- Proxies: Comment 36(d)(1)-2

Questions *(continued)*

Compensation based on terms or conditions *(continued)*

- Pricing concessions—comment 36(d)(1)-5
  - "Point banks"
  - State "high-cost" laws
  - Penalizing loan officers for GFE tolerance violation or other compliance failures
    - Legal fees and losses for liability through LO's fault
- Net branches—compensation based on "profitability"
- Equity ownership
  - "Producing owners"
  - Employee stock options

Questions *(continued)*

Compensation based on terms or conditions *(continued)*

- Compensation based on terms or conditions of previous transactions
- Compensation based on amount of credit extended
  - "Tiering"
    - Transaction level
    - Aggregate volume level
  - Reverse mortgages—maximum claim amount vs. initial principal balance
- Premium yield rate in relation to LO compensation amount
  - Third-party closing costs

Questions *(continued)*

Compensation based on terms or conditions *(continued)*

- Periodic revisions to compensation agreements
  - Basis of revisions going forward also must comply with rule
  - “Periodic”—six months in comment 36(d)(1)-6 is an example
- Long-term loan performance
- Source of creditor-paid compensation not limited to YSP
- Different arrangement for each loan originator

Questions *(continued)*

Compensation paid directly by consumer—226.36(d)(2)

- Commission to mortgage broker employee
  - Equivalent transaction through creditor-paid alternative
- Seller contributions
- RESPA "credit to borrower"
  - Third-party fees paid with YSP

Questions *(continued)*

Affiliates treated as single person—226.36(d)(3)

- Multiple creditors that are affiliated with one another
- Multiple loan originators (mortgage brokers) that are affiliated with one another
- Third-party service providers that are affiliated with a loan originator

Questions *(continued)*

“Steering”—226.36(e)

- Applies to both brokerage company and employee
- Satisfaction other than through safe harbor
  - Transaction in consumer’s interest
  - No greater compensation

Questions *(continued)*

"Steering" *(continued)*

- Safe harbor
  - Obtain options from "significant number" of creditors with which loan originator regularly does business:
    - Present loans that satisfy the three criteria—need not necessarily present three loans; 226.36(e)(4).
    - Need not <u>present</u> loans from all creditors from which options were <u>obtained</u>; comment 36(e)(3)-1.
  - Lowest total "origination points or fees and discount points"
  - "Lowest interest rate"—note rate
  - Once safe harbor satisfied, "best execution"

Questions *(continued)*

Record retention—226.25(a)

- Compensation agreement in effect on the date the interest rate was set for the transaction
  - *See* 226.35(a) and comment 35(a)(2)-3: agreement in effect when rate is locked for the last time

- Actual amount paid to loan originator

Questions *(continued)*

- Other questions from webinar participants

  » Thank you!

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