

LENDERS UPDATE™

A MONTHLY SERVICE TO THE MORTGAGE LENDING INDUSTRY

AN ALT & ASSOCIATES NEWSLETTER

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August 19, 2010

LOAN ORIGINATOR COMPENSATION

As we briefly summarized in our August 16th Lenders Update, on that day, the Federal Reserve Board issued several proposed, interim or final Rules on a number of subjects. Of these, the one that would seem to have the most immediate impact is the Rule which imposes restrictions on loan originator compensation on closed end mortgage loans. We would like to provide you with a reasonably detailed summary of these Rules as they will apply to your mortgage lending or brokerage company. The Rules take effect April 1, 2011.

As you probably observed in our brief summary or in other reports, the new Rule seems similar to portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Federal Reserve Board intends to move forward with promulgating regulations to implement those provisions on a later date. Until then, the Rules we are presently summarizing, will control the issue.

The new Rule applies to loan originators, which include individuals and companies acting as mortgage brokers. The Rule also applies to loan originators who serve as loan officers and are employed by mortgage lenders and depository institutions. In states which allow table funding, a company which “does not provide the funds for the transaction... out of the creditor’s own recourses....” is a table funder and considered a mortgage broker.

Except as it applies to its loan officers, the Rule does not, in most instances, have a direct effect on creditors. A creditor is an entity that funds its own loans from its own bonafide credit line or its own deposits.

The significant portions of the Rules we are discussing apply to closed end loans secured by a consumer’s dwelling. For these loans, the new regulations impose 3 major limitations or restrictions.

- **First, they prohibit payments to the loan originator that are based on the loan’s interest rate or other terms.** In other words, a loan originator cannot receive more compensation than he/she would otherwise receive strictly by increasing the loan’s interest rate, points or other terms.

The regulations prescribe an illustrative list of compensation methods or factors that are permissible. These include:

- the loan originator’s overall volume,
- long term performance of the originator’s loans,
- an hourly rate of pay compensating the originator for the actual number of hours worked,
- a fixed payment for each loan arranged by the originator,
- the pull-through rate of applications submitted by the loan originator, and
- the quality of the loan originator’s files.

It is permissible for an originator's compensation to be based on a fixed percentage of the amount of the credit extended. This fixed amount may have minimum and maximum amounts. This may be particularly significant when dealing with small loans.

- **Second, a broker or loan officer is prohibited from receiving payments directly from a consumer while also receiving compensation from the creditor or other third party.** To say it another way, if a loan originator receives payments from a creditor or other party he/she is barred from receiving other compensation from the borrower except for bonafide and reasonable third party fees, such as insurance or appraisals.

Payments to a loan originator which are made out of loan proceeds are considered compensation received directly from the consumer. Payments derived from increased interest rate are not considered compensation directly from the consumer. Points paid on the loan by the consumer to the creditor are not considered payments received directly from the consumer, whether they are paid in cash or out of loan fees. In other words, if the consumer pays origination points to the creditor, and the creditor compensates the loan originator then the loan originator may not also receive compensation directly from the consumer.

Whether the payment is considered compensation to the originator depends on whether the loan originator retains the payment. It is not dependent on the label or name of any fee imposed in connection with the transaction. For example, as the Rule states, if a mortgage broker imposes a processing fee on the consumer in connection with the transaction and retains such fee, it is deemed compensation. At that point, the broker could not receive other compensation from the creditor or a third party.

- **Finally the mortgage broker or loan officer is prohibited from "steering" the consumer to a loan offering terms less favorable to the borrower in order to**

increase the broker or loan officer's compensation. For such actions to constitute steering, the consumer must actually consummate the transaction in question because the restrictions discussed in the new Rule do not apply unless the consumer actually obtains a loan. However, a loan originator may direct or steer a customer even if the loan originator would increase the amount of his/her compensation, if the consummated transaction is in the consumer's interest.

The new Rule provides a "Safe Harbor" to allow originators to comply with the anti-steering Rule:

- *"a consumer is presented with loan offers for each type of transaction in which the consumer expresses an interest...."* such as fixed rate loans or adjustable rate loans.
- The loan offers to be presented to the consumer must include the following information:
 - the lowest interest rate for which the consumer qualifies,
 - the lowest points and fees,
 - the lowest interest rate for which the consumer qualifies which does not include risky terms such as prepayment penalties, negative amortization or a balloon payment.

The rules pertaining to how these procedures are to be implemented are reasonably complex and at times, unclear. However, in general, to be considered a possible loan offer available to the borrower, an actual offer need not be extended by the creditor to the borrower. The possible loan need only be an offer that the creditor would likely extend upon receiving the borrower's application, based on the creditor's current standards.

Repeatedly within the explanation of the final Rule, the Federal Reserve acknowledges that the new regulation will require a change in practice and business models for most brokers

and creditors. The Board also realizes that it will have significant impact, particularly on small businesses. However, the FRB found that the benefit to consumers outweighs the detriment to the mortgage brokers and loan originators.

We look forward to answering any questions you may have.

Our Lenders Update is published via e-mail as a complimentary service to our friends and clients in the financial industry throughout California and the United States. Only those persons who have requested this newsletter are on our mailing list. Should you have colleagues who wish to receive this complimentary service, please have them e-mail us at

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ALT & ASSOCIATES provides regulatory, compliance, operational advice and transactional assistance, as well as litigation representation, to the financial services industry. Over the past two decades, members of the firm have represented Institutional Lenders and Mortgage Bankers and Brokers in all aspects of their operations. If you have any questions please contact:

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