

LENDERS UPDATE™

ALT & ASSOCIATES NEWSLETTER

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LOAN ORIGINATOR COMPENSATION RULES THE SECOND ROUND

As we have discussed before, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) placed additional restrictions on loan compensation paid to Mortgage Loan Originators (“MLOs”) beyond the Loan Originator Compensation Rule (“Rule”) implemented in April 2011 by the Federal Reserve Board (“FRB”). These additional provisions will supplement and sometimes significantly amend the Rule. This Rule and the implementation of Dodd-Frank are now the responsibility of the Consumer Finance Protection Bureau (“CFPD”). According to the provisions of the Dodd-Frank, the CFPD must implement the additional Dodd-Frank requirements related to MLO Compensation qualification through rulemaking or the provisions will automatically take effect as written in January, 2013.

To further this process, on May 9, 2012 the CFPD issued an outline of proposals under consideration. To emphasize, these are not new rules and in some cases they are

not even proposals for new rules. However they do discuss the direction in which the CFPD is currently leaning and may significantly comprise the new rules to be proposed this summer and ultimately implemented. The outline is 37 pages long. It is available on the CFPD website. Find the press release dated May 9, 2012 which directs you to the websites containing the fact sheet, an overview of the rules under consideration, a list of questions for input, etc.

For those of you who do not wish to review all of this documentation, we thought it might be useful to briefly summarize general proposals under consideration.

1. Creditor Paid Compensation

Dodd-Frank generally prohibits upfront payment of points and fees. This law however allows the CFPD under certain circumstances to propose exemptions from this prohibition. CFPD's proposal would allow upfront points and fees subject to the following conditions:

- ✚ Consumers can pay discount points, provided the discount points are bonafide and a no discount point loan is offered as an option.
- ✚ Origination charges may be paid, but they must be flat and not vary with the size of the loan.
- ✚ Upfront fees may be paid to affiliates provided the fees are flat and again do not vary with the size of the loan, (exception given to title insurance).

2. Broker Paid Compensation

Dodd-Frank contains a complete prohibition on a broker payment to an individual broker payment if the consumer has paid the brokerage fee. This is also consistent with the Rule. The CFPD has considered a proposal in which it would exercise its exemption authority and issue a rule permitting brokerage-paid compensation structures imposing the same conditions as on upfront points and fees paid by consumers to creditors and their affiliates. In other words discounted points must be bonafide and origination fees must be flat, and not vary based on the size of the loan.

3. Compensation varies based on loan term.

Dodd-Frank does not allow MLOs to receive compensation based on the terms of the loan. This is also the position of the Rule, but the rule does not apply to consumer paid transactions. The proposed rules would implement this statutorily required change. In other words, the ban on varying compensation based on terms of the loan would apply to consumer paid and broker paid compensation

4. Compensation Includes Profits.

Under the Loan Originator Rule, compensation includes several enumerated items including salaries and commissions as well as annual or periodic bonuses. Terms or Conditions mean interest rate, APR, LTV and prepayment penalties. To what extent to these rules apply to qualified or non-qualified retirement plans? The board is considering proposals that would allow MLO compensation paid from mortgage business profits where the compensation is substantially deferred in time or where there are other safe guards present to mitigate steering incentives. The three proposals range from: 1) allowing these contributions on a general basis even if based on profit, 2) allowing compensation to be based on profit, if the profit from the mortgage business is limited to a set percentages or 3) permitting a bonus but requiring an employer to not compensate based on the profitability of a loan he/she originates.

5. Pricing Concessions.

The Rule does not allow creditors and brokerages to set the MLOs compensation at a certain level and then lower it in selective cases where different loan terms are negotiated. This would effectively circumvent the rule prohibiting compensation based on terms or conditions of the loan. Dodd-Frank would extend the application of this prohibition. The CFPD is considering a proposal that would allow MLOs to make certain types of pricing concessions to cover unanticipated increases in third-party settlement charges where the settlement charges are not controlled by the MLO, the creditor or their affiliates and exceed or are in addition to the amounts disclosed on the Good Faith Estimate disclosure required by RESPA.

6. Point Banks.

In a “point bank” a creditor contributes points to a MLO for each transaction that the MLO closes or based on other issues. The MLO can then use the points to obtain

pricing concessions. For example the MLO may pay discount points to the creditor from the MLOs point bank in order to obtain a lower rate for the consumer. In the Federal Reserve Board webinar on Loan Originator Compensation rules held in March of last year, Paul Monder, then of the FRB, stated that it would be hard to imagine point banks which complied with rules. The CFPD is considering clarifying that point banks fall within the definition of compensation and are prohibited but also to provide guidance on arrangements that would not violate the prohibition.

They are considering the following clarifications:

- ✚ Point Banks are those funded based on the difference between the rate required by the creditor for a given consumer and the actual rate the MLO sells the consumer or based on the difference between the other terms required and the actual term the MLO sells the consumer.
- ✚ Point Banks funded by a creditor are permissible if the creditor does not base the amount of the contributions on the terms and conditions of an individual transaction, the creditor does not change its contributions over time based on the terms and conditions and if the creditor permits an MLO to overdraw the bank, the creditor does not reduce the MLOs commission on a transaction in which the MLO does so.

7. Proxies

The Rule states that compensation based on a factor that is a proxy for the transactions term or condition is prohibited because they would allow circumvention of the ban on compensation based on the terms and conditions of the loan. The commentary to the Rule, identifies credit scores and debt to income ratios as examples of factors that are proxies. However, as any of us attempting to operate or advise others of how to operate, under this concept the term proxy is, at best, uncertain. The CFPD states that it does not want to abandon the concept but wishes to provide examples of what proxies are and adopt an analytical framework to clarify the proxy concept to ease compliance.

At the moment the CFPD is considering the following test to determine whether a factor is a proxy for a loan term:

A factor is a proxy if 1) it substantially correlates with the loan term, and 2) the MLO has the discretion to use the factor to present a loan to the consumer which more costly or less advantageous term(s) on a loan available through the MLO for which the consumer likely qualifies.

8. Miscellaneous.

Proposals also under consideration include new retention requirements for MLOs. They would require brokerages in addition to creditors to maintain records of MLO compensation or arrangements' and agreements and maintain records of compensation provided to MLOs.

The CFBB is also considering changing the MLO qualification and screening requirements. The SAFE Act requires entities who are not depositories, to license their employee MLOs. Depository institutions and non-profits are not subject to these Safe Act requirements. Depository institutions or non-profits would be required to insure that their MLO employees meet character, fitness and criminal background standards equivalent to the licensing standards of the Safe Act and that they provide appropriate training to their MLO employees. The object is to provide parity between MLOs that work for different types of entities.

As stated at the beginning of this article, we can presume that we will be hearing significantly more on these issues over the next seven or eight months.

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