ALT & ASSOCIATES NEWSLETTER

A COMPLIMENTARY SERVICE TO THE MORTGAGE LENDING INDUSTRY

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LOAN ORIGINATOR COMPENSATION
THE NEW RULE

INSTALLMENT 2

Last week we began a three-part series on the Consumer Financial Protection Bureau's (CFPB) final Rule amending loan originator compensation requirements under the Truth in Lending Act. The new Rule primarily implements the requirements and restrictions of the Dodd-Frank Act. The provisions we are discussing become effective January 10, 2014.

Again we note that we cannot provide legal advice in this medium, but we can provide summaries of the lengthy material, particularly the comments and interpretations which have been published by the CFPB. In our INSTALLMENT 1, we discussed in some detail the definition of a loan originator. This week we will discuss compensation issues as they arise under the final Rule.

INSTALLMENT 2
Compensation.

Compensation includes salaries, commissions and any financial or similar incentive. Examples provided by the Bureau include bonuses, awards of merchandise, services, trips or similar prizes.

The name by which the compensation is called is irrelevant. If a loan originator imposes a processing fee and retains that fee, it is compensation for purposes of the Rule. However, compensation does not include amounts a loan originator receives as payment for bona fide and reasonable charges which are passed on to a non-affiliated third party. Further, compensation received for charges for services that are not loan origination activities are not loan originator compensation.

In some cases amounts received by the loan originator for payment for third-party charges may exceed the actual charge, for example, if the loan originator cannot determine with accuracy what the actual charge will be when it is imposed and instead uses average charge pricing in accordance with the Real Estate Settlement Procedures Act. The difference retained by the loan originator organization is not compensation if the charge imposed on the consumer or collected from a person other than the consumer is bona fide and reasonable and <u>also complies with state and other applicable law</u>.

On the other side, if the loan originator organization marks up the charge and the originator retains the difference between the actual charge and the marked up charge, <u>the amount retained is compensation</u>.

Compensation also includes stock, stock options, or equity interests provided to loan originators. If a person is awarded stock or equity based on the terms of consumer credit transaction or transactions, <u>then that is compensation</u>. Bona fide returns or dividends paid on stock are not compensation. Bona fide returns or dividends mean those returns and dividends are paid pursuant to a documented ownership or equity interest.

With these general comments, we turn to specific issues with loan originator compensation.

- **As most of us know compensation cannot be based on a term of the transaction. The determination of this fact is based on the objective circumstances indicating compensation would have been different if the transaction term had been different.**

- **Compensation that directly or indirectly is based on the terms of a single transaction, or the terms of multiple transactions of that individual, or the terms of transactions of multiple loan originators, is also encompassed. Compensation to a loan originator that is based upon profits determined with reference to a mortgage related business is considered compensation that is based on the terms of the transactions of multiple individual loan originators. This is forbidden.**

  -The Bureau uses two examples the first of which is to assume the creditor pays a bonus to an individual loan originator out of a bonus pool established with reference to the creditor's profits and the profits are determined with reference to the creditor's revenues from origination of closed-end consumer credit transactions. In this instance the bonus is considered compensation under a deferred profit base compensation plan and prohibited. (We will discuss issues related to profit plans in our next installment).

  -The second example assumes the loan originator's contract guarantees a quarterly bonus and a specified amount conditioned upon the originator meeting certain performance benchmarks such as monthly volume of originations. If the conditions are met, the creditor is obligated to pay the bonus, regardless of the terms of the transaction or the effect on the creditor's profits. This is not based on the term of the transaction and is permissible.

- **The Rule does not prohibit compensating a loan originator differently on different transactions provided the difference is not based on a term of the transaction or a Proxy for a term of the transaction Proxy has been word largely undefined up until this time. The new Rule prohibits compensation to a loan originator per transaction based on criteria such as the transactions interest rate, annual percentage rate, collateral type, or the existence of the prepayment penalty. The Rule also prohibits compensation to a loan originator that is based on any factor that is a Proxy for a term of the transaction.**

- **If the loan originators compensation is based in whole or in part on a factor that is a Proxy for term of the transaction, then the loan originators compensation is based on a term of the transaction. A factor is a Proxy if the factor consistently varies with the term or terms of the transaction over a significant number of transactions and the loan originator has the** ability directly or indirectly to add, drop or change the factor when originating the transaction.

-Assume a creditor pays a loan originator higher commissions for transactions to be held by the creditor in portfolio than for transactions sold by the creditor into the market and the products have different terms and interest rates. Thus an extension of credit held in portfolio or sold in the market varies the interest rate and the terms of the transaction. The loan originator has the ability to change this factor by, for example, advising the consumer to choose an extension of credit with a rate that will mean that the loan will be placed in the portfolio. Therefore under the circumstances, whether or not an extension of credit will be held in portfolio is a Proxy for terms of the transaction.

-Assume a loan originator organization pays loan originators higher commissions per transaction secured by property in state A than in state B. This is caused by lower interest rates in state B. A loan originator however does not have any ability to influence whether the transaction is in state A or B so compensation is not based on the term of the transaction. This is not a Proxy.

- Compensation based on the following factors is not compensation based on a term of the transaction and is allowable. These factors include overall dollar volume or number of loans, long-term performance of loans, hourly rate of pay or salary, whether the consumer is an existing customer of the creditor or a new customer, a fixed payment for every loan of say $600 per transaction, pull through rate, or the quality of the loan originators files including accuracy and completeness. Compensation can change based on these factors.

Remember that the Rule also does not limit a creditor from offering or providing different loan terms to the consumer based on the creditor's assessment of credit and other risks. This is not the case for a loan originator. Thus, a creditor and the loan originator may not agree to set the loan originators compensation at a certain level and subsequently lower it in selected cases where the consumer is able to bargain for a lower rate. An originator’s compensation for the transaction is not subject to change based on whether different credit terms are negotiated. Further, a loan originator

cannot agree to reduce compensation or provide a credit to the consumer to pay a portion of the consumer's closing costs.

However, in a significant change in the new Rule, a loan originator is not prohibited from decreasing its compensation to defray the cost, in whole or in part, of an unforeseen increase in actual settlement costs over the estimated settlement costs disclosed. The increase can occur only if the estimate provided to the consumer is consistent with the best information reasonably available to the disclosing person at the time of the estimate.

Our last installment, INSTALLMENT 3, coming in a few days, will discuss:

- **pooled compensation,**
- **designated tax advantage plans,**
- **non-deferred profit based compensation plans and**
- **other related issues.**

These issues represent some of the most significant changes under the new Rule. In addition we will discuss dual compensation and compensation received from the consumer.

Stay tuned again.

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