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AN ALT & ASSOCIATES NEWSLETTER

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HAS THE WORLD OF LOAN ORGINATOR COMPENSATION RULES BECOME MURKIER- OR IS THAT EVEN POSSIBLE?

The State Mortgage Regulators released Mortgage Loan Originator Compensation Guidelines in October of this year. The Multi State Mortgage Committee ("MMC") created by the Conference of State Supervisors and the American Association of Residential Mortgage Regulators issued examiner guidelines to assist state regulators of non-depository mortgage loan originators and creditors with their review of licensee policies and practices. The Multi State Mortgage Committee is a group of 10 state representatives.

The guidelines present a detailed and standardized set of procedures for evaluating compliance with the L/O Compensation Rule.

According to the MMC, the guidelines are only intended for the purpose of providing a standard set of examination tools to determine compliance with "bright line" areas of the Rule. They are not intended to provide instructions for every compliance scenario that may arise.

HOW DO THESE FIT IN WITH THE CURRENT STRUCTURE?

As you recall, on September 24, 2010 the Federal Reserve Board published its final Rule on loan originator compensation and this Rule became effective, after a brief administrative stay, on April 6, 2011.

The Fed's new Rule is an amendment to Reg. Z which implements the Truth in Lending Act. It also includes official staff interpretations of this new Section 226.36 (the Loan Originator Compensation Rule). However, in the lead up to the effective date, many questions were posed to representatives of the Fed, particularly to Staff Counsel, to interpret some of the many ambiguities in the Rule. As a result, in private conversations, group meetings and public Webinars, the Fed issued a large number of basically helpful interpretations of the Rule. However, these comments were largely unwritten, unbinding, informal guidance.

At the same time as the Fed was working on its Final Rule, the Dodd-Frank Act was passed and enacted. One of Dodd-Frank's many provisions amended the Truth in Lending Act in a number of respects and one of those was related to Mortgage Originator Compensation. These provisions are separate from the Fed's Final Rule on the subject. Although they do, to some extent, follow the same principles, they are not coextensive. These new Dodd-Frank provisions are to be effective upon implementation of the final rule by January 2013.

Dodd-Frank however also took regulatory authority for consumer protection statutes away from the Federal Reserve Board and gave it to a newly created Consumer Protection Bureau ("CFPB"). The CFPB has the authority to draft and finalize the second new Rule

on Loan Originator Compensation mentioned in the last paragraph. This new Rule, will, of necessity, implement the increased scope of the changes to the Truth in Lending Act, and change and, to some extent, broaden the Fed's Original Rule. Also remember, the CFPB is not bound by ANY of the informal guidance provided previously by the Fed, in the spring of 2011.

Now, to make things more complicated, the MMC has issued its guide to state enforcement. We repeat that these guidelines do not affect depository institutions. The Federal Financial Institutions Examination Council approved interagency examination procedures for the new rule and they were implemented prior to the actual effective date of the Fed's Rule.

The MMC guidelines can be found at:

http://www/csbs.org/news/press-releases/pr2011/Pages/pr-100711.aspx

Before summarizing these rules please remember once again that they are guidelines to provide a standardized set of procedures for state examiners to use in reviewing institutions for compliance with the Rule. Hopefully they will be used for that purpose, as a structure to determine compliance rather than a guideline to determine an individual institution's compliance with all aspects of the Rule.

The guidelines are divided into 3 sections:

1. **Module 1 is a checklist to be completed by the State Examiner.**
2. **Module 2 is a list of information to be requested by the Examiner.**
3. **Module 3 is a questionnaire to be completed by the institution.**

The guidelines apply to residential mortgage loans, including reverse mortgage loans (that are not lines of credit), but do not apply to Home Equity Lines of Credit ("HELOC's"),

time share transactions and loans secured by real property if the property does not include a dwelling.

MODULE 1

- **Section A. The first section includes a checklist to aid in the review a licensee's policies and procedures. It includes a review of 1. written policies and procedures, 2. Compensation paid, 3. loan officer's compensation agreements, 4. payments by creditors, 5. payments by consumers, 6. dual compensation, and 7. compensation based on terms or conditions, etc.**
- **This second portion of Section A calls for a review of loan compensation to determine if it is based on terms or conditions paid by any person other than the borrower and to identify situations in which a payment to an originator was not based on the terms and conditions of the loan. It suggests 3 basic tests:**
  - **Was payment based on rate or other terms and conditions?**
  - **Was payment made by any person other than the borrower?**
  - **Was payment made to the loan originator? Where a loan originator receives compensation that correlates to different loan terms or conditions, lender must justify the distinction on other grounds, such as the difference in the level of work required of the originator. (While it has been suggested by the Fed that this may be permissible grounds for a change in compensation, it may well be an issue subject to further review and comment by the CFPB).**
- **Section B. These guidelines suggest that the examiner look for evidence that the compensation was based on the interest rate or annual percentage rate, LTV, prepayment penalty, credit score, debt to income, or that the loan originator was paid compensation based on loan amount other than compensation based on the actual number of loans made or the volume of loans.**

It is suggested under Section 2, that the examiner determine whether or not the loan originator has retained any compensation as a result of "up charging" costs on a third party's services such as charging $100 for a $50 fee.

There are a number of miscellaneous review items set out for the examiner in this section such as changes in loan originator compensation based on cost, creditor costs or loan terms and dual compensation issues in which the borrower has paid compensation to the loan originator who also received compensation from the creditor.

- **Section C. This section provides suggestions to the examiner to determine if a borrower has been steered to a loan in order for the originator to receive greater compensation. It suggests two basic tests:**
  1. **Did the loan originator make greater compensation than would have been made, all other things being equal?**
  2. **If the answer to the first question is positive, then is the loan NOT in the borrower's interest.**

  The guidance further suggests that if both tests have been met, the examiner must determine if the loan originator complied with "safe harbor" provisions. Finally the module points out that steering does not apply to <u>creditors</u> unless they are acting as mortgage brokers and further, that their employees satisfy the anti-steering provisions as long as they are not compensated based on later terms of the loan.

MODULE 2

- ***Institution Information Request List.***

  This module sets out information that it suggests that examiners request from their institutions. These include:

- **Policies, procedures, and guidelines for maintaining compliance with Loan Originator Compensation Rule, human resource records, and payroll records.**
- **Third party originator records.**
- **A list of all employees or independent contractors who have received compensation as a loan originator during the examination period.**
- **A list of all third party originators that have submitted loan originations to the institution.**
- **Copies of any reports produced for monitoring compliance with the Rule.**
- **A list of compensation situations that required an exception to the written policies.**
- **A list of all institutions, with which the creditor regularly does business, that originate or make residential mortgage loans.**
- **A list of third party service cost sheets from which the institution prices services.**

MODULE 3

- ***Institution Questionnaire*. This is a lengthy and detailed questionnaire. If you check the content on the website you will note on the questionnaire that the MMC believes it will save both time and resources for both the institution and the examination team ….well maybe the examination team.**

It is our experience in advising many clients over this past year that some feel that a fleeting, laissez faire attitude toward adherence to the new Rule may be sufficient. It is however apparent from the remarkably detailed and extensive suggested examination protocol, that a substantial day to day effort would be required to meet a compliance examination conducted pursuant to this protocol.

Beyond this, it also our concern that guidelines as proposed will lead state examiners who may only have passing familiarity with the Rule, to seek in its examinations, compliance with the guidelines as opposed to the actual Rule itself.

At best, proving compliance will be a significant and ongoing task.

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