LOAN ORIGINATOR COMPENSATION

Regulation Z – Final Rule -- Effective April 1, 2011

Who is a Loan Originator?

- The term "loan originator" includes both individuals and entities.

- ***A mortgage broker is a loan originator*.**

- **An employee of a mortgage broker and/or creditor is a loan originator if the employee meets the definition on the previous slide.**

- **The funding lender in a table-funded transaction is a loan originator.**

Who is a <u>NOT</u> Loan Originator?

The following are also <u>not</u> loan originators:

- **Loan servicers (unless “refinancing”)**
- **Consumers (Borrowers)**
- **Real Estate Brokers (unless compensated for a loan)**

Loan Originator Prohibitions under Reg Z

- **The August 16, 2010 Final Rule amending Regulation Z establishes <u>3 key prohibitions on Loan Originators</u>:**

  1) **A loan originator <u>*may not*</u> directly or indirectly receive (and a person cannot pay) compensation based upon any of the terms or conditions of the loan.**

  2) **If a loan originator receives compensation directly from a consumer, the loan originator <u>*may not*</u> receive compensation from the creditor (or any other person) in connection with the transaction.**

  3) **A loan originator <u>*may not*</u> "steer" a consumer to a loan based on the fact that the loan originator will be paid more on that loan (as opposed to other available loans), unless the loan is in the consumer's interest.**

PROHIBITIONS

Prohibition #1

- A loan originator ***may not*** directly or indirectly receive (and a person cannot pay) compensation based upon any of the terms or conditions of the loan.

Let's break this down and discuss what is meant by "compensation" and "terms and conditions of the loan."

Prohibition #1

Compensation includes:

- **Salaries**
- **Commissions**
- **Any financial or similar incentive**
- **Merchandise**
- **Prizes**
- **Trips**
- **Fees paid to a Loan Originator (such as a processing fee)**

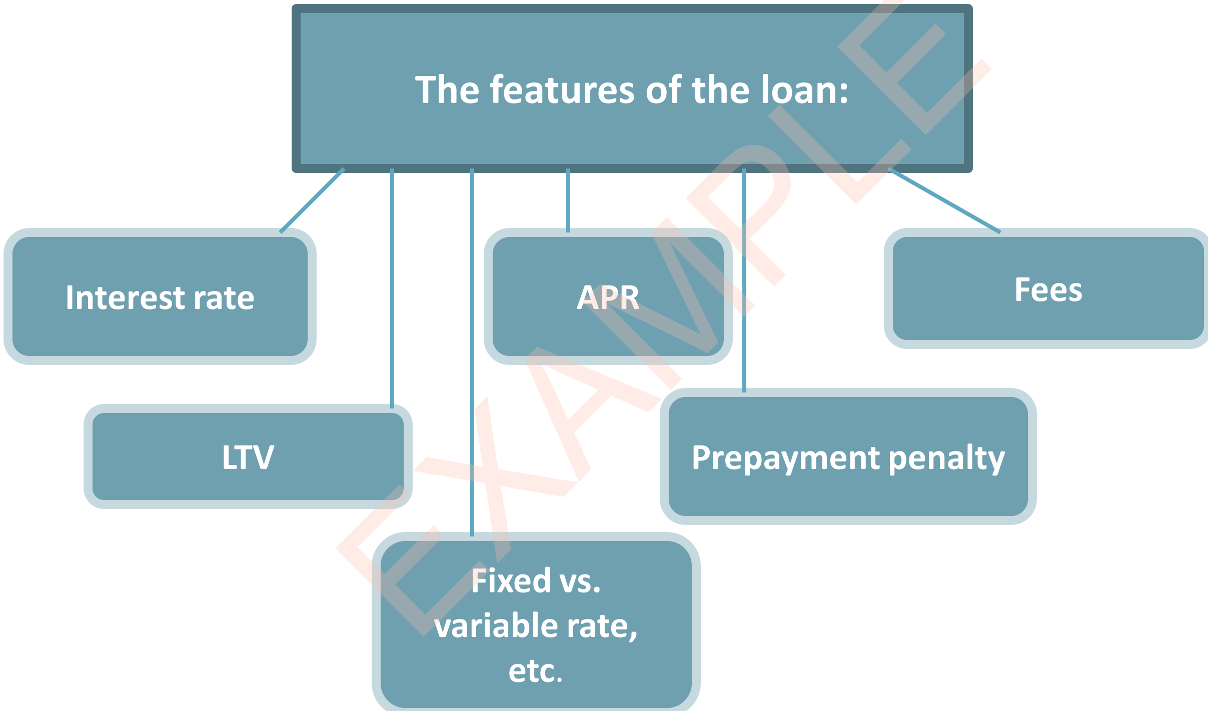
Compensation <u>DOES NOT</u> include:

- **Bona fide and reasonable 3rd party charges (e.g., title insurance or appraisals)****

****Note – Beware of "upcharging." See example later in "Examples and Explanations."**

Prohibition #1 (continued)

<u>What is a term or condition of the loan</u>?



****<u>*Note*</u> -- This will eliminate loan originator compensation based on the "profitability" of the loan.**

Prohibition #1 (continued)

- ***<u>Examples of compensation that are not based upon the terms or conditions of the loan</u>*:**
  - **The loan originator's overall loan volume (dollar amount or units).**
  - **The long term performance of the originator's loans.**
  - **Hourly wages for actual hours worked.**
  - **Whether the consumer is an existing or new customer.**
  - **A fixed payment for every loan that the originator arranges for a creditor (e.g., $600 per loan, or $1000 for the first 1000 loans and $500 for each additional loan).**
  - **A percentage of applications submitted by the loan originator to the creditor that result in a closed loan.**

Prohibition #3

- **A loan originator may not "steer" a consumer to a loan based on the fact that the loan originator will be paid more on that loan (as opposed to other available loans), unless the loan is in the consumer's interest.**
  - **As a practical matter, this prohibition applies to traditional mortgage brokers.**
  - **"Steering" means directing, advising, counseling, or otherwise influencing a consumer to accept a particular transaction.**

Note that there are four exceptions to Prohibition #3.

Exceptions to Prohibition #3

- ***<u>Exception #1</u>*:**
  - **The loan originator directs the consumer to consummate a transaction, after presenting the consumer with a significant number of available loan options, that results in the <u>least</u> amount of *creditor* paid compensation.**

- ***<u>Exception #2</u>*:**
  - **The loan originator directs the consumer to consummate a transaction, after presenting the consumer with a significant number of available loan options, that results in the <u>highest</u> amount of *creditor* paid compensation if the terms and conditions for all of the loan options for which the consumer qualifies are the same.**

<u>Example #9</u>:

Q: Can a mortgage company enter into 2 separate commission agreements with 2 different mortgage brokers, such that Mortgage Broker A receives a 1.5% commission per loan and Mortgage Broker B receives a 2.5% commission per loan?

A. Yes. Again, the Fed rule <u>does not require</u> that all Loan Originators receive the same compensation.

Examples and Explanations (Loan Terms)

Example #10:

Q: Can a Loan Originator charge $400 for an application fee, if he assumes the credit report will cost $50 and the appraisal will cost $250?

A. No. This would be an example of impermissible upcharging. This can be illustrated as follows:

Loan A

- **Borrower charged $400 Application Fee**
- **Credit report = $50**
- **Appraisal = $300**
- **The Appraisers from whom the LO chooses *usually charge between $300 and $350.***
- **Loan Originator may keep $50 – this is not deemed compensation.**
- **THIS IS NOT UPCHARGING**

vs.

Loan B

- **Borrower charged $400 Application Fee**
- **Credit report = $50**
- **Appraisal = $300**
- **The Appraisers from whom the LO chooses *usually charge between $250 and $300.***
- **Loan Originator may not keep $50 .**
- **THIS IS UPCHARGING**

Examples and Explanations (Loan Terms)

<u>Example #12</u>:

Q: My company has 2 offices:

- **1 in <u>New York City</u>, which closes on average <u>45 loans per month</u>, and**
- **1 in <u>Fargo, North Dakota</u>, which closes about <u>4 loans per month</u>.**

Can I pay my Loan Originators in Fargo a higher commission?

A. Yes. Commentary Section 226.36(d)(i)-3.viii provides for varying compensation to Loan Originators based on geographic area. To encourage Loan Originators to originate loans in rural areas, those Loan Originators can be paid a higher commission than those originating loans where there is more significant lending volume.

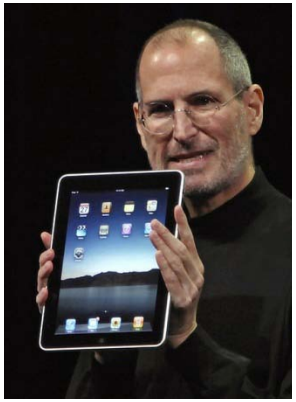
Examples and Explanations (Loan Terms)

Example #18:

Q: Can a mortgage company compensate its Loan Originators such that it pays each Loan Originator \$1,000 per loan for the 1st 500 loans arranged, and then \$700 for each additional loan arranged?

A. Yes. Again, a payment plan fixed in advance for every loan the Loan Originator arranges for the creditor is an example of permissible compensation.

Examples and Explanations (Loan Terms)



Example #19:

Q: Can a mortgage company offer an incentive promotion to its Loan Officers, such that the Loan Officer with the highest average interest rate on his originated loans each quarter receives an iPad (service plan not included)?

A. No. Compensation to Loan Originators cannot be based on loan terms (including interest rate). Compensation includes any periodic bonus and any merchandise, services, or trips.

Examples and Explanations (Loan Terms)

Example #26:

Q: Can a mortgage company compensate the Managers of its branches based on branch profits if the Manager has management responsibilities and also originates some loans?

A. No. If a branch Manager originates loans, then the Manager cannot receive compensation based on loan terms. Being a Loan Originator subjects all compensation received by the Manager to the Fed rule, even compensation received in the Manager's capacity as a manager. It should be notes, however, that the Manager, like other originators, can receive a fixed percentage amount of all loans originated.

Examples and Explanations (Steering)

Example #27:

Q: In the scenario below, can the Broker steer the Borrower to Creditor B's Loan?

Creditor A Loan		Creditor B Loan
•Borrower qualifies for loan •Same terms/conditions as Creditor B Loan •Loan is in the Borrower's interest •Pays Broker 4% Commission	vs.	•Borrower qualifies for loan •Same terms/conditions as Creditor A Loan •Loan is in the Borrower's interest •Pays Broker 5% Commission

***A. Yes.** The steering prohibition is not violated when the Loan Originator (the Broker) directs the Borrower to a loan that will result in greater compensation to himself provided that the terms and conditions on that loan – compared to other possible loan offers available through the Loan Originator and for which the Borrower qualifies – are the same.*

THANK YOU

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