

Lenders Compliance Group

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Loan Originator Compensation: New Rules

On January 24, 2013, as the last of the Final Rules of the Consumer Financial Protection Bureau (CFPB) rolled out, I offered an outline of all of them, entitled "[CFPB's Gang of Seven \(Final Rules\)](#)".*

I listed them in order of issuance, as follows:

1. Ability-to-Repay (ATR)
2. High-Cost Mortgage (HCM)
3. Escrow
4. Servicing
5. Appraisals for High-Risk Mortgages
6. Copies of Appraisals
7. Mortgage Loan Originator Compensation

Having come through the last two months responding to numerous questions about these Final Rules, I have been able to cobble together some of the most salient questions, regulatory features, and concerns that our clients have expressed about them. And when I have spoken to the media types, it seems that they also have a set of questions and interests that are not being fully addressed in the current dialogue. Of abiding interest is the change relating to loan originator compensation.

With that in mind, I want to provide a brief outline of some loan originator compensation issues, offering additional details garnered from two months in the trenches working through these regulatory issues on behalf of our clients. From time to time, I will have more to discuss about many regulatory changes anticipated in 2013 and 2014. I am going to conduct this review topic by topic, rather than just as specific regulations subject to a final rulemaking.

IN THIS ARTICLE

Terms and Conditions
Retirement Plans
Factors and Proxies
Dual Compensation
Non-loan Originations Services
Points and Fees
Loan Originator Qualifications
Mandatory Arbitration Clause
Single Premium Insurance
Record Retention Requirements

Terms and Conditions

By now, there is nary a residential mortgage lender or originator that does not know that, under Regulation Z, loan originator compensation is prohibited from being based upon the terms and conditions of a mortgage loan transaction.

The CFPB has provided new nomenclature for the terminology "transaction terms and conditions," without much changing the prohibition and certain exceptions to the standing rule. The new terminology is "term of a transaction," but now with the clarified meaning that *term of a transaction* means to include "any right or obligation of the parties to a credit transaction."

The usual cast of regulatory prohibitions continue in force. For instance, loan originator compensation is still prohibited from being based on such things as the interest rate of a loan, or upon the inclusion of additional fees or charges for products or services provided by other parties to the transaction.

And the usual cast of regulatory identifiers of a term of a transaction continue in force. Thus, fees or charges are a term of the transaction if they must be disclosed in the Good Faith Estimate (GFE) or HUD-1 or HUD-1A Settlement Statement (HUD-1). That obviously means to include loan originator or creditor fees or charges for the credit transaction or for a product or service provided by the loan originator or creditor that is related to the extension of credit; and it also means those fees or charges of other parties for any product or service required by the lender as a condition of the extension of credit. Keep in mind, however, that just because a fee or charge is stated on the HUD-1 does not in itself make the fee or charge a term of the transaction.

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change a term of the transaction. One rather controversial area involves the off-setting of compensation due to increased costs. The standing rule has provided that loan originator compensation is prohibited from being reduced in response to a change in the transaction terms. This has caused lenders all manner of frustration, not to mention loss of revenues and diminished profits. Yet, the new rule would allow compensation to be reduced in order to offset unexpected increases to estimated settlement costs, otherwise known as "unforeseen circumstances." What is a circumstance that is *unforeseen*? The imagination reels! But since the CFPB has offered no formal guidance to delineate very specifically what may or may not be an unexpected event, the lender must be extremely careful not to enter these dark waters too briskly.

Retirement Plans

Profits may be used toward contributions to tax advantaged retirement plans. The important feature is to ensure that such contributions are not be based on the terms of the individual loan originator's transactions. Non-deferred, profit based compensation plans - such as bonus pools and profit-sharing plans - is permissible. However, any such payments (1) must ensure that compensation is not directly or indirectly based on the terms of the individual loan originator's transactions, and (2) either the compensation under the plan does not exceed 10 percent of the loan originator's total compensation for the applicable period or the loan originator was an originator for no more than 10 transactions during the preceding 12 months.

Whatever the choice, the entity involved must ensure that payments do not include bonuses, awards, trips, or other 'incentive' products or services.

Factors and Proxies

Although the standing rule provides that loan originator compensation may not be dependent upon a factor that is a "proxy" for what would otherwise be considered a term of a loan transaction, there is clarification now that a factor is a term of a loan transaction "proxy" if it meets these two criteria: (1) the factor varies with a transaction term over a significant number of transactions, and (2) the loan originator, directly or indirectly, has the ability to add, reduce, or change the factor when originating the loan or credit.

Dual Compensation

There is no change to the prohibition against dual compensation. As by now everyone knows, a loan originator may not be compensated by both the creditor and the consumer. However, mortgage brokers are permitted to pay commissions to their employees and contract agents, provided that these commissions are not based upon the term of a transaction.

Non-loan Originations Services

Any amounts received by an origination entity or mortgage broker entity - that is, a lender or brokerage - or its affiliates for activities that are not related to loan originations are not deemed to be compensation. This means that compensation does not include a payment received by such an entity (or its affiliate) for *bona fide* and reasonable charges for services it performs that are not related to loan originations, and by a lender or brokerage for *bona fide* and reasonable charges for services that are not loan origination activities when those amounts are not retained by the loan originator but are paid to the lender or its affiliate, or the brokerage or its affiliate.

Points and Fees

The CFPB initially proposed a rule in August 2012 that set forth an exemption for the upfront points and fees prohibition. This weird creature of a loan product was called the "zero-zero alternative." If the borrower qualified for it, the lender had to offer it as an alternative loan product.

Lenders opposed the zero-zero and the CFPB then provided a complete exemption, under which a lender may impose points and fees on a consumer where the lender pays compensation to a loan originator - as long as the consumer does not also pay a loan originator.

But is this exemption the unequivocal law of the land? Not really! The CFPB actually reserved to itself the right to amend the exemption after it has conducted additional research on this matter.

Loan Originator Qualifications

The SAFE Act, Dodd-Frank, and applicable state law govern all mortgage loan originating entities to make certain that their loan originator employees and agents are either appropriately licensed or registered. Banks and certain nonprofit entities are required to ensure that their registered loan originators meet character and background standards essentially similar to those established under the SAFE Act for licensed loan originators.

Therefore, registered loan originators are subject to the same rules regarding criminal background checks, credit reporting, and Nationwide Mortgage Licensing System and Registry (NMLS) checks as licensed loan originators. Registered loan originators must receive training on federal and state law requirements that apply to loan origination activities.

The CFPB provides more parameters for the thresholds pertaining to background checks, such as when a criminal conviction will disqualify an individual from being a loan originator and when a criminal background or credit check is mandatory.

There is a clarification to where the loan originator's NMLS unique identifier is to be included on loan documents, such as the requirement for it to be placed on the credit application, note, or loan contract, and security instrument. The unique identifier, however, does not have to be stated on the HUD-1 or Truth in Lending Act (TILA) disclosures.

Mandatory Arbitration Clause

Effective June 1, 2013, there is a prohibition against any loan contract or other agreement related to a consumer residential mortgage or home equity transaction from including or requiring mandatory arbitration of disputes. This prohibition does permit the parties to agree to arbitration once a dispute commences.

Specifically prohibited are contract or loan agreement provisions that would bar or limit a consumer from seeking relief in court for any claimed violation of federal law, and interpretations of provisions of loan documents which would bar a consumer from bringing a claim in court in connection with any alleged violation of federal law.

Single Premium Insurance

Premiums or fees for credit life insurance and similar products may not be financed in connection with a consumer credit transaction secured by a dwelling. Credit insurance may only be paid on a monthly basis.

Record Retention Requirements

As with nearly all regulatory mandates, it is important to retain records. Given the ability to keep documents in an electronic format, many (but not all) records can be kept permanently in that format. Nevertheless, the CFPB has directed residential mortgage lenders and originators to maintain records related to loan originator compensation for a period of at least three years after the date of the compensation payment. Documents to retain would surely include, but not be limited to, compensation agreements with loan originators as well as all payments made to the loan originators.

Library



Loan Originator Compensation

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