Tuesday, February 15, 2011

Compensation: One Statute Too Many?

Jonathan Foxx is a former Chief Compliance Officer of two publicly traded financial institutions. He is the President and Managing Director of Lenders Compliance Group, the nation's first full-service, mortgage risk management firm in the country.

As I've previously notified you, I am writing an article on the loan officer compensation requirements that are due to go into effect on April 1, 2011. While I have been writing the article, in the current environment some of our clients seem to be forming a sort of siege mentality.

And I can't blame them, since there is so much confusion and, more substantively, the actual reading of federal staff commentaries to specific statutes in the revised TILA are causing them quite a bit of consternation.

We'll look at just one of the more controversial provisions!

Going too far?

Let's read the following passage together, slowly, carefully, attentively.

Below I will deconstruct it.

We are going to consider the FRB commentary on a TILA section, entitled "Compensation in connection with a particular transaction" [§ 226.36(d)(2)]:

> "If any loan originator receives compensation directly from a consumer in a transaction, no other person may provide any compensation to a loan originator, directly or indirectly, in connection with that particular credit transaction. ... The restrictions imposed [under this section] relate only to payments, such as commissions, that are specific to, and paid solely in connection with, the transaction in which the consumer has paid compensation directly to a loan originator.
>
> Thus, payments by a mortgage broker company to an employee in the form of a salary or hourly wage, which is not tied to a specific transaction, do not violate [this section] even if the consumer directly pays a loan originator a fee in connection with a specific credit transaction.
>
> However, if any loan originator receives compensation directly from the consumer in connection with a specific credit transaction, neither the mortgage broker company nor an employee of the mortgage broker company can receive compensation from the creditor in connection with that particular credit transaction."

Interpolation & Interpretation

Now, permit me to unpack this language and render it in less ambiguous terms:

First, let's recognize that the terminology and phrasing in this provision are somewhat mangled. For interpretive ease, staying within the context of the commentary itself, it seems entirely clear that the "loan originator" is a mortgage broker, a company or employer.

Second, I will use some literary license and call the employee of a mortgage broker a "loan officer."

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So, here goes my interpolation and interpretation:

Compensation tied to Transaction

Text: If any loan originator receives compensation directly from a consumer in a transaction, no other person may provide any compensation to a loan originator, directly or indirectly, in connection with that particular credit transaction. ... The restrictions imposed [under this section] relate only to payments, such as commissions, that are specific to, and paid solely in connection with, the transaction in which the consumer has paid compensation directly to a loan originator.

Interpolation: When a mortgage broker is directly compensated by a consumer, no other compensation may be provided to the mortgage broker from another source, directly or indirectly.

Interpretation: When the consumer directly compensates the mortgage broker in a transaction, the mortgage broker may not receive additional compensation from any other source, directly or indirectly; but, the text does not restrict the mortgage broker from paying a portion of such compensation to the loan officer.

Example

Text: Thus, payments by a mortgage broker company to an employee in the form of a salary or hourly wage, which is not tied to a specific transaction, do not violate [this section] even if the consumer directly pays a loan originator a fee in connection with a specific credit transaction.

Interpolation: The mortgage broker may pay salary or hourly wages to a loan officer for originating loans that are not tied to a specific loan transaction, although a consumer may pay a fee to the mortgage broker to originate a specific loan.

Interpretation: Salary and hourly wages are incidental to loan officer compensation, when not tied to a specific loan transaction, irrespective of whether a mortgage broker receives direct compensation from a consumer for a particular transaction.

Source of Compensation

Text: However, if any loan originator receives compensation directly from the consumer in connection with a specific credit transaction, neither the mortgage broker company nor an employee of the mortgage broker company can receive compensation from the creditor in connection with that particular credit transaction.

Interpolation: When a mortgage broker is directly compensated by a consumer in a transaction, no other compensation may be paid to the mortgage broker and the loan officer by the creditor.

Interpretation: Compensation paid directly by the consumer to the mortgage broker on a transaction concomitantly causes the elimination of the mortgage broker's and loan officer's ability to receive compensation by the creditor.

Does the FRB disagree with itself?

One would think that the plain meaning of the text - such as it may be derived in its own context - is sufficiently clear to make sense of the FRB's actual position on loan officer compensation, at least with respect to compensation directly paid to mortgage loan originators by consumers.

However, some of our clients have contacted me about an alleged position unofficially circulated by the FRB itself, which seems to contradict my aforementioned interpretations. Various industry and media organizations are stating that the FRB allegedly holds that loan officers can be paid only salary or hourly wages on loan transactions where mortgage broker compensation is directly received by the consumer. Supposedly, this view is alleged to be held by certain industry organizations and some lawyers who are offering legal opinions.

Perhaps I am in the minority, but the plain meaning of the text - as I see it - does not prevent a loan officer from receiving compensation from a mortgage broker on specific loan transactions where compensation to the mortgage broker is directly paid by the consumer, so long as the above-mentioned constructs are fully met. If it were otherwise, certain TILA statutes - and numerous RESPA statutes, and various provisions in the Dodd-Frank Act - would become incoherent.

I don't think I've got the wrong interpretation. Maybe the FRB should read its own statutes and then revise its own commentary.

And if the allegation is true, is the FRB asserting that some kind of "dual compensation" would take place if mortgage brokers shared a portion of their commission with their loan officers? I think that conclusion would be contrary to a fair reading of the above-outlined provision.

An official clarification would be nice!

Until that happens - and I expect it to happen! - let's keep in mind that the rampant confusion in the mortgage industry, caused in no small part by the revised loan officer compensation requirements, is just one more reason why the implementation date of April 1, 2011 should be delayed.

Postpone Implementation

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The FRB needs to provide credible, clear, and unambiguous information for the entire residential mortgage industry in order to expect systemic compliance with foundational changes.

Here are two recent newsletters we have sent out on this subject.

SBA - 2nd Request to Postpone New LO Compensation Rules (2/1/2011)

FRB's Loan Officer Compensation "Guidance" (1/31/2011)

Until the mortgage industry:

(1) adequately understands its Regulation Z (TILA) enforcement obligations and loan officer compensation requirements; and

(2) has been given the statutorily mandated findings of the overall economic impact on the industry of the aforementioned provision, among others; and

(3) receives a complete and comprehensive mortgage compliance guide from the FRB, containing the requisite outline provided by the SBA's Office of Advocacy;

and until, that is, other planning requirements are met, I don't see how compelling the implementation of the loan compensation requirements on April 1, 2011 can be viewed as anything but disruptive, if not destructive, to the livelihoods of mortgage loan originators.

Labels: Dodd-Frank Act, FRB, Loan Officer Compensation, MLO, Mortgage Broker Compensation, Mortgage Compliance, Mortgage Loan Originator, Mortgage Originator Compensation, Regulation Z, RESPA, TILA

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Company Description

Lenders Compliance Group is the first full-service, mortgage risk management firm in the country, specializing exclusively in mortgage compliance and offering a full suite of services in mortgage banking. We are pioneers in outsourcing solutions for residential mortgage compliance. We offer our clients real-world, practical solutions to mortgage compliance issues, with an emphasis focused on operational assessment and improvement, benchmarking methodologies, Best Practices, regulatory compliance, and mortgage risk management.

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