American Mortgage Law Group, P.C. and The Mortgage Collaborative Joint Webinar Series

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The Loan Originator Compensation Rule in 2017: Updates and Developments

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James W. Brody

As a Managing Member, Mr. Brody actively manages complex mortgage banking mitigation and litigation matters for the American Mortgage Law Group, P.C. ("AMLG") and its diverse clientele (e.g., national mortgage lenders, warehouse lenders, secondary market investors, loan servicing companies, Wall Street banking firms and insurers). Being one of the AMLG's founding attorneys, Mr. Brody has been instrumental in the Firm's development and in its continued success.

Mr. Brody has successfully resolved hundreds of mitigation and litigation cases that involve complex mortgage fraud schemes, as well as large-scale repurchase and/or make-whole disputes. Mr. Brody's experience centers on those legal issues that arise during and through loan originations, loan purchases/sales, loan securitizations, foreclosures/ bankruptcy actions, and repurchase/make- whole claims.

Mr. Brody received his B.A. in International Relations from Drake University in 1997. He also received his J.D., with a certified concentration in Advocacy, from the University of the Pacific, McGeorge School of Law in 2000. In addition to being admitted to practice law in all State and Federal Courts in CA, Mr. Brody has served as lead litigation counsel for numerous mortgage banking and commercial related disputes venued in both State and Federal Courts, in a direct capacity or on a *pro hac vice* basis, in AZ, CA, FL, MD, MI, MO, OR, NJ, NY, PA, TN, and TX.

Mr. Brody has made numerous media appearances and industry presentations regarding the prevention, detection and resolution of mortgage fraud matters. In addition, Mr. Brody continues to be a featured speaker in the area of repurchase and make-whole claims. Mr. Brody may be reached at jbrody@americanmlg.com or at 415-246-3995.

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Brief Introduction to American Mortgage Law Group, P.C.

AMLG is a nationally recognized full suite mortgage banking law firm that represents a diverse clientele (e.g., mortgage lenders and servicers, commercial banks, thrifts, savings and loan associations, credit unions, title companies, third-party vendors, etc.), both in and out of court, either directly or in a *pro hac vice* capacity, all across the country.

<u>We focus on:</u>

- Mortgage Repurchase and Indemnification Defense & Workout
- Litigation & Mitigation
- Regulatory Compliance & Examinations
- White Collar Defense
- Public Speaking and Education at Conferences

Find out more at: americanmlg.com

Jennifer Peachman

Jennifer Peachman is the Director of Member Engagement at The Mortgage Collaborative, the nation's only independent cooperative network in the mortgage industry. Founded in 2013, TMC is a cooperative of mortgage companies who work together to increase profitability and market share. Jen supports the engagement of TMC lender members with the network's preferred partners and strives to create greater connectivity between TMC's member and vendor partners. Jen supports the expansion of member benefits, all member needs and requests, and marketing initiatives for The Collaborative.

In her role with TMC, Jen supports member recruitment efforts and manages The Collaborative's educational and networking platform, facilitating educational, training and networking activities. Jen is also responsible for the development, communication, and execution of calls, webinars, electronic communications and in-person events.

Jen is a 15-year veteran of the mortgage and financial services industry, holding previous positions in mortgage operations & administration, marketing, corporate communications, business analysis, employee engagement & development, instructional design, sales training and onboarding. Before joining TMC, Jen was employed at First Federal Lakewood, PNC and National City Bank, all headquartered in Cleveland, OH.

She holds a Bachelor of Arts from Baldwin-Wallace University in Organizational Leadership, with a focus in Human Resources and various professional certifications, including instructional design, leadership and human resources.

Brief Introduction to The Mortgage Collaborative (TMC)

Based in San Diego, California, The Mortgage Collaborative was founded in 2013 to empower mortgage lenders across the country with better financial execution, reduced costs, enhanced expertise and improved compliance, as well as helping our members access the dynamic and changing consumer base in America.

Better execution. Lower costs. Continuing education and powerful networking. Strategies for a changing market.

The MORTGAGE COLLABORATIVE

Learn more about the Mortgage Collaborative by visiting www.mortgagecollaborative.com

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Why The Mortgage Collaborative?

- **60 best-in-class preferred partner companies** that all provide TMC lender members powerful discounts/incentives.
- **Year-long educational and peer-to-peer networking platform** to help your firm operate more intelligently and strategically.
- **Tools and resources to help member companies adapt** to the industry's emerging technology and the evolving demographics of the American home buyer.
- **Improved home buying experiences** for customers.
- **We are the nation's only independent cooperative** network for the mortgage lending industry.

Notice

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Webinar Agenda

- Stated Purpose of the Rule: Preventing Steering and Protecting the Consumer
- Key Elements of the Rule
- Prohibited Compensation Structures
- Permitted Compensation Structures
- Varying LO Comp by Loan Product
- Compensation Pools
- Point Banks
- Proxies of Loan Terms
- Claw-backs for Loan File Quality
- EPO/EPD Claw-backs
- Revisions to Compensation Plans
- Paying LOS as Independent Contractors
- Unforeseen Settlement Costs
- "Pick a Plan" Structures
- Permitted Profits-based Compensation
- Recent Enforcement Actions
- LO Comp Record Retention Requirements

Stated Purpose of the Rule:

Prevent Steering

Protect Consumers

Key Elements of the Rule

- Prohibits compensation based on loan terms, or a proxy for loan terms, other than loan amount

- Prohibits compensation from both the consumer and another person

Prohibited Compensation Structures

- **Varying LO Comp by Loan Product**

  Loan Product = Bundle of Terms

- **Compensation Pools**

  Terms of multiple transactions by multiple LOs

- **Point Banks**

  CFPB: "there should be no circumstances under which point banks are permissible" Rule Preamble

- **Sliding Scale %**

  1% for loans ≥$300K, 2% on $200K-$300K, 3% for loans < $200K

- **Basing LO Comp on Sold vs. Portfolio**

  Proxy

Proxy of a Loan Term

- **Consistently varies with a term or terms of the transaction over a significant number of transactions**
- **LO has the ability, directly or indirectly, to add, drop, or change the factor when originating the transaction**

EXAMPLES

QM vs. Non-QM
FHA vs. Conventional
Bond Program vs. Non-bond Program
CRA vs. non-CRA
DTI/LTV

Not a Proxy of a Loan Term

- **Overall Dollar Volume**
- **Long Term Performance of Loans**
- **Hourly rate for actual hours worked**
- **Existing Customer vs. New**
- **Fixed Fee Per Unit**
- **Percentage of Submitted that Close**
- **Quality of loan files (such as accuracy and completeness)**

Questionable Practices

- **Clawbacks for Quality of the LO’s Files**
  - **Not contemplated by safe harbor for loan quality**
  - **Build quality loan factors into your LO comp structure**
- **EPO/EPD Clawbacks**
  - **Pattern of error? Could be a proxy**
  - **Compensation should be set in advance**
  - **May run contrary to state employment laws**
- **Frequent Revisions to Compensation Plans**
  - **No more than once every 6 months**
  - **Document the reason for the change**
- **Paying LOs differently for purchases vs. refinances**
  - **No express carve-out**
  - **Bundle of terms**

Questionable Practices (cont.)

- **Paying an LO as an Independent Contractor**

  "For purposes of § 1026 . . . the individual loan originator's total compensation consists of the sum total of: (1) all wages and tips reportable . . . on IRS form W-2 (or, if the individual loan originator is an independent contractor, reportable compensation on IRS form 1099-MISC) . . ." 36(d)(3)(v)

IRS Control Test

Independent Contractor	Employee
Payer directs result only	Employer directs what and how

Loan Originator ≠ Independent Contractor

Proceed with Caution

- **LO Comp Reduction to Cover Rate Lock Extension Fee or Cure Tolerance Violation**
  - **Unforeseen**
  - **Document the decrease and the reason for it**
- **Varying Comp by State**
  - **Does one state have lower credit scores?**
  - **Higher interest rates?**
  - **Might be a proxy**
- **Source of Lead**
  - **Probably not a proxy**
  - **Avoid RESPA kickbacks**

Permissible Comp Structures

- **Different Compensation Structures for Different LOs**
  - **Not based on loan terms**
  - **Not paid by both borrower and lender**
- **Toggling between borrower and lender paid compensation**
- **Minimum/Maximum**
  - **Ex: 1% of loan amount on all loans but not less than $1000 or greater than $5000 for each loan**
- **Guaranteed Specific Benchmark Bonus**
  - **Not based on loan terms**
  - **Not subject to 10% limit**
- **Sign-on and Retention Bonuses**
  - **Not based on profits**
  - **Budget in advance**

Permissible Comp Structures (cont.)

- **Pick a Plan Structures**

Option 1-No Assistant

Monthly Volume ~non construction loans~	Commission in bps
< $1,000,000	115 bps
≥ $1,000,000 & < $2,000,000	110 bps
≥ $2,000,000	105bps

Option 2 – Assistant

Monthly Volume ~non construction loans~	Commission in bps
< $1,000,000	125 bps
≥ $1,000,000 & < $2,000,000	125 bps
≥ $2,000,000	125 bps

Permissible Comp Structures (cont.)

- **Designated Tax-Advantaged Plan**
  - **Meets specific IRS guidelines like 401(k)s**
  - **Contributions cannot be directly or indirectly based on the terms of an individual LO's transactions**

Permissible Comp Structures (cont.)

- **Non-deferred Profits-based Compensation Plan**
  - **Contributions cannot be directly or indirectly based on the terms of an individual LO's transactions**
  - **AND…**

Capped at 10% of LO's total comp for same period	OR	Individual LO was an LO for 10 or fewer transactions during the preceding 12-month period

  - **Can include affiliate profits**
  - **Awards of merchandise, services, trips, etc., count toward 10%**

P&L Branch Exercise

- **Scenario**
  - **Producing Branch Mgr**
  - **Comp = Revenue to branch less OH/Costs**
  - **Balance to BM**
- **Analysis**
  - **Loan Originator? Yes**
  - **Is comp directly/indirectly based on terms of multiple transactions by multiple LOs? Yes**
  - **Permitted non-deferred plan? No**
  - **Violation**
  - **Consider fixed % on originations and cap bonus at 10%**

CFPB Enforcement Actions

- July 2013, Castle & Cooke Mortgage LLC
  - Quarterly bonuses varied based on interest rate
- Nov 2014, Franklin Loan Corporation
  - Bonuses from expense accounts funded by retained rebates
- June 2015, Guarantee Mortgage Corporation
  - Fees to marketing services entities that weren't supposed to include income from loans actually did

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Record Retention Requirements

- Who?
  - Creditors
  - Loan Originator Organizations (Sole Proprietors)
- What?
  - Comp Agreements
  - Records sufficient to evidence all comp paid/received
    - Nature and amount
    - That it was paid/received and by whom
    - When each occurred
    - Reductions for unforeseen settlement cost increases and reasons
- How long?
  - 3 years

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Thank You

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