



December 16, 2010

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Sandra F. Braunstein
Director, Consumer and Community Affairs Division
Board of Governors of the Federal Reserve System
1709 New York Avenue, NW, Room 8021
Washington, DC 20006

Dear Chairman Bernanke and Director Braunstein:

The Mortgage Bankers Association¹ writes today to respectfully request written guidance from the Federal Reserve Board of Governors (Board) to assist the mortgage industry's compliance with the Board's final rule on loan originator compensation and steering (the Rule) published on September 24, 2010.²

The Rule is far-reaching and requires major changes to long-operating compensation practices that heretofore have been both legal and prevalent. Unfortunately, in our view, the Rule does not definitively address many matters of particular importance, and has engendered numerous questions from creditors and loan originators seeking to comply. Notwithstanding, it requires compliance by April 1, 2011.

Specifically, the Rule prohibits: (1) basing compensation to a loan originator on a loan's terms or conditions, subject to a limited exception for loan amount; (2) compensation to a loan originator from both the consumer and a party other than consumer for the same

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

² 75 FR 58509 (Friday, September 24, 2010)

transaction; and (3) an originator from steering a consumer to receive greater compensation.

While we appreciate that Board staff has been available to respond verbally and in person to questions from MBA and its members – and very graciously has agreed to participate in an MBA webinar – unfortunately verbal guidance in itself is insufficient. The Rule was issued pursuant to the Board’s authority to prohibit unfair and deceptive acts and practices and its violation can lead to substantial civil liability, criminal penalties and administrative sanction. In recognition of the significant potential liability under the Truth in Lending Act (TILA), Congress shielded from liability, creditors that in good faith follow Board or official staff interpretations. Lenders and investors, therefore, are wary of proceeding without written direction. If guidance is not forthcoming, many lenders may be forced to be very conservative and implement compensation and loan pricing structures that provide for fixed compensation for originators at a level that can only be supported by higher loan prices to consumers.

Additionally, we believe many of these informal conversations with staff have resulted in responses that go beyond or vary from the Rule, suggest interpretations of the Rule that are not evident from the proposed Rule, present unintended consequences or are otherwise unwise. Respectfully, we hope the process of reducing advice to written guidance will clarify staff thinking. Also, there are several differences between the Rule and the Dodd-Frank Act.³ While we believe these differences would support withdrawal of the rule and a new rulemaking to reconcile these differences, at the very least, written guidance should be provided mindful of the future Dodd-Frank rulemaking.

To facilitate the process of preparing written guidance, we have taken the liberty of developing the attached set of questions and answers (Q’s and A’s) that: (1) reflects the verbal guidance Board staff has provided on some issues; and (2) what we believe the Board’s guidance is likely to be on other issues, including new questions submitted to MBA since we met with the Board.

Please note, in instances where we question whether verbal advice is appropriate, we have also provided what we strongly believe is a better response consistent with the Rule for the Board’s consideration. We have also provided responses for newer questions that have not been answered. We label these preferred responses and the responses for newer questions “MBA Proposed Response” for the Board’s consideration.

³ Examples include that Dodd-Frank prohibits several specific types of steering, including steering a consumer from a favorable loan to a less favorable loan regardless of the compensation of the loan originator or creditor. The Fed rule, however, takes a different view of steering, first by restricting steering based on compensation and then by interpreting its compensation rules as an anti-steering rule. Also, while Dodd-Frank prohibits compensation that varies based on the terms of the loan, it allows compensation to vary based on the principal amount of the loan without any conditions. In contrast, the Fed rule only permits the use of fixed percentage of the loan amount, subject to optional minimum and maximum dollar amounts that also must be fixed.

Generally, these Q's and A's do not address matters that are clearly addressed in the Rule though in a few cases such material is restated to provide context for follow-up questions. For reference, in this letter, we also provide a few examples of the many areas of concern and even consternation embodied in the Q's and A's.

For example, Board staff has indicated verbally that there cannot be differences in loan originator compensation for the origination of an FHA loan, a loan under a special program for low- and moderate-income families or a conventional loan program because of concerns about the possibility of steering. While the Rule provides guidance that originators may not be compensated based on product differences, it also indicates they may be compensated based on differences in hours worked or overhead. The Q's and A's include the verbal response of Board staff and also offer as an MBA Proposed Response that such compensation may differ where it can be shown based on a *bona fide* analysis that average costs and time spent to originate these differing products justify compensation differences. Notably, this position was rejected verbally by Board staff, without any apparent rationale for why *bona fide* computations of average costs and time are inappropriate while loan-by-loan determinations, which approach is operationally infeasible, apparently would be permitted. Inflexibility on this important point essentially reads out of the rule the ability to base compensation on costs and time spent to originate loans.

Similarly, Board staff has indicated verbally that compensation may not differ based on whether a loan is originated for a purchase transaction or for a refinance transaction for the stated reason of avoiding steering. The Rule did not address the issue. While the Q's and A's include the staff response, since we cannot conceive of any real possibility of steering a borrower in need of a purchase loan into a refinance, or vice versa, the Q's and A's offer as an MBA Proposed Response that such compensation may also differ based on cost experience justifying compensation differences.

Also, Board staff has indicated verbally that managers who originate any mortgage loans may not be compensated based on the revenues of their branches because branch revenues to some extent include compensation based on rate or terms. The Rule simply provides that managers are exempt from the restriction on compensation based on rate or terms. The Q's and A's include the response of Board staff, and offer a MBA Proposed Response that would permit a manager's compensation to be based on revenues when the manager provides a *de minimis* number of originations, along the lines of the Board's *de minimis* exception from TILA coverage. The Q's and A's also offer a response for situations in which a manager originates more than a *de minimis* number of loans – the response provides that in such situations compensation to a manager for loans originated would be excluded from any revenue based compensation to that manager.

As the Q's and A's make clear, MBA disagrees with several of the staff positions expressed verbally and would welcome an opportunity to discuss them further. Nonetheless, we strongly believe that written guidance should be made available as

efficiently as possible well prior to the implementation date – even if we disagree with the answers.

If the intent of the Board is to foster implementation of the Rule in a compliant and uniform manner, the intent will not be served by leaving unaddressed the significant issues regarding the Rule that are presented in the Q's and A's. Silence will lead to varying interpretations that will not serve the Rule's purpose. If the Board cannot provide written guidance prior to the implementation date, we respectfully urge that it postpone implementation of the Rule pending such guidance.

Thank you for your consideration of this letter and attached Q's and A's. We greatly appreciate the Board's guidance on these important issues.

Sincerely,

A handwritten signature in cursive script that reads "John A. Courson".

John A. Courson
President and Chief Executive Officer
Mortgage Bankers Association

Attachment

cc: James A. Michaels, Assistant Director
Division of Consumer and Community Affairs
Federal Reserve Board

**Questions on
Federal Reserve Loan Originator Compensation Rule
Mortgage Bankers Association
December 15, 2010**

GENERAL QUESTIONS

1. **Restrictions on compensation.** What does the restriction on compensation based on terms cover and how does it apply to payment of compensation or other costs through rate?
 - A. **Fed Response** - The Commentary accompanying the rule says that the restriction against compensation based on a transaction's terms includes the interest rate, annual percentage rate, loan-to-value ratio, or the existence of a prepayment penalty. The rule also prohibits a proxy for a transaction's terms or conditions such as credit score.

2. **Permissible compensation.** If compensation cannot be based on a transaction's terms, on what can it be based?
 - A. **Fed Response** - Compensation that is not based on a loan's terms may include:
 - i. The loan originator's overall loan volume (*i.e.*, total dollar amount of credit extended or total number of loans originated), delivered to the creditor.
 - ii. The long-term performance of the originator's loans.
 - iii. An hourly rate of pay to compensate the originator for the actual number of hours.
 - iv. Whether the consumer is an existing customer of the creditor or a new customer.
 - v. A payment that is fixed in advance for every loan the originator arranges for the creditor (*e.g.*, \$600 for every loan arranged for the creditor, or \$1,000 for the first 1000 loans arranged and \$500 for each additional loan arranged).
 - vi. The percentage of applications submitted by the loan originator to the creditor that results in consummated transactions.
 - vii. The quality of the loan originator's loan files (*e.g.*, accuracy and completeness of the loan documentation) submitted to the creditor.
 - viii. A legitimate business expense, such as fixed overhead costs.
 - ix. Compensation that is based on the amount of credit extended.

3. **For purposes of (ii) above what is meant by long term-performance?**
 - A. **Fed Response** - The term means any reasonable period of time over which the overall performance of an originator's loans can be measured including the time in which early payment defaults or payoffs occur. "Long term performance" is intended to cover overall performance of the originator's loans not the performance of individual loans. The language was not intended to require or permit loan-by-loan claw back based on loan performance. Lenders can consider early payment default or payoffs in overall loan originations of the originator with regard to the originator's future compensation or bonuses.

SPECIFIC QUESTIONS

4. **Adjustment of compensation based on amount of credit extended.** Assuming a creditor establishes a fixed percentage of loan amount compensation for a particular type of loan, how frequently may the creditor adjust the compensation to the originator?
 - A. **Fed Response** - Over any reasonable period of time that would support a finding that compensation requires adjustment, provided such adjustment does not lead to loan-by-loan adjustment; not more frequently than every two weeks.

5. **Compensation variations for purchase and refinance loans.** Can the compensation to a loan originator vary based on whether a loan is a purchase or a refinance?
 - A. **Fed Response** - No, not if purchase and refinance loans are priced differently. In such cases, purchases or refinances become proxies for different rates and originators cannot be compensated differently for them. There is danger if there is differential compensation that consumers will be steered to whichever transaction results in greater compensation to the loan originator. If purchase and refinance transactions are priced the same, these dangers are not present.
 - B. **MBA Proposed Response** - Yes, if purchase and refinance loans are priced differently and it can be shown that variations in compensation are based on legitimate business expenses and/or differences in hours to originate purchases versus refinances. Assuming the originator is paid a fixed dollar or percentage amount for each type of loan, it is permissible to establish an average cost/time to originate per type of loan and establish compensation based on the average. There is virtually no danger that a consumer can be steered to a refinance loan rather than a purchase loan or vice versa; the loans address different consumer needs.

6. **Compensation variations for origination of FHA, VA or Conventional loans.** Can the compensation to a loan originator vary based on whether a loan is a FHA, VA or Conventional loan?
 - A. **Fed Response** - No. If FHA, VA and Conventional loans are priced differently, the loans become proxies for different rates and originators cannot be compensated differently for them. If there is differential compensation that some consumers will be steered to whichever transaction results in greater compensation to the loan originator.
 - B. **MBA Proposed Response** - Yes, if it can be shown that the variation in compensation is based on differences in legitimate business expenses and/or differences in hours to originate. It is permissible to establish an average cost/time to originate per type of loan and establish compensation based on the average. Creditors report considerable differences in costs to originate FHA, VA or conventional loans, and should not have to establish compensation based on the specific costs and time associated with each individual loan, as that would be operationally burdensome if not impossible for larger volume lenders. Additionally, there is no reasonable basis not to permit commission to be established based upon *bona fide* determinations of average cost and time. Just as origination costs for different channels may vary (see Question 32 below) so, too, may origination costs for loan products.

7. **Portfolio vs. Non-Portfolio.** Can the compensation to a loan originator vary based on whether a loan is to be held in portfolio or a loan that will be sold?
- A. **Fed Response** - No, if portfolio and non-portfolio loans are priced differently, they become proxies for different rates and originators cannot be compensated differently for them. There is danger if there is differential compensation that some consumers will be steered to whichever transaction results in greater compensation to the loan originator.
 - B. **MBA Proposed Response** - Yes, if retention in portfolio was based on variations in transaction costs between portfolio and non-portfolio loans then compensation variations are permissible to that extent. However, it *would not* be permissible if the creditor determined what loans are retained in portfolio and what loans are sold based on the terms of the loans – in that case whether a loan is a portfolio loan or a non-portfolio loan would be a proxy for loan terms and the loan originator's compensation could not vary based on whether the loan was retained or sold. For example, if a bank retained loans with lower interest rates and sells loans with higher interest rates, then portfolio versus non-portfolio would be a proxy for loan terms.
8. **Incentive Compensation Questions.** A creditor has an incentive compensation plan for originators that is based on the originator's loan volume over a particular period. It is not tied to loan terms. It is based on a fixed percentage of the aggregate principal balance of loans originated by the loan originator during the period.
- a. Can payment of the incentive compensation to the originator be conditioned on the company, region or branch achieving a certain level of profit during the period?
 - A. **Fed Response** - No. Permitting lenders to base compensation decisions on profits may lead to basing compensation on terms or conditions. The rule does not permit this at this time.
 - B. **MBA Proposed Response** - Yes. The requirement of a certain level of profit simply protects the creditor against having to pay incentive compensation for a period if the creditor (or its region or branch) has not been sufficiently profitable during the period. The profit trigger alone does not result in a loan originator being compensated based on the terms of any particular loan.
 - b. What if the profit is calculated in whole or part based on the aggregate value of loans originated during a particular period?
 - A. **Fed Response** - Yes. It would be permissible. Calculating compensation based in whole or part on the aggregate value of loans would not result in a loan originator being compensated impermissibly based on the terms of any loan.
9. **Compensation thresholds.** Can an incentive compensation plan for a loan originator based on loan volume provide for different percentage amounts based on the aggregate dollar volume of the loan originator's loans over a particular period (such as X basis points for an aggregate volume over \$5.0 million and less than \$10.0 million, Y basis points for an aggregate volume over \$10.0 million and less than \$15.0 million, and Z basis points for an aggregate volume over \$15.0 million)?

A. **Fed Response** - Yes. Such an incentive compensation plan would not result in compensation that is based on the terms of any particular loan. The compensation is based only on aggregate loan volume levels, and the number of loans that it would take to reach each level would not be consistent from period to period, thus the compensation would not even be indirectly based on the terms of any particular loan.

10. **Loan originator pricing.** Can a loan originator establish a price for a loan that is higher than the price offered by the creditor, such as 1 percent of the loan instead of the 75 basis points offered by the creditor as long as the loan originator's compensation does not vary based on the loan terms (except for a fixed percentage of the loan amount, subject to a fixed minimum or maximum dollar amount)?

A. **Fed Response** - Yes. The rule restricts basing loan originator compensation on the loan terms, and not the pricing of a loan when the loan originator compensation does not vary based on the terms of the loan.

11. **Managerial employees.** Can a manager be compensated based in whole or part on profits during a particular period attributable to an area over which the manager has authority, such as a branch manager with respect to a branch? Can profits be calculated in whole or part based on the aggregate value of loans originated during a particular period in the applicable area based on secondary market value?

A. **Fed Response** - Yes. As a general matter for purposes of the restriction in § 226.36, managers, administrative staff, and similar individuals who are employed by a creditor or loan originator but who do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, and whose compensation is not based on whether any particular loan is originated, are not loan originators subject to the prohibition against compensation based on rate or terms. Accordingly, such a manager or similar staff can be compensated based in whole or in part on profits including aggregate value of loans.

The calculation of the aggregate value of loans can be based on secondary market value or other metrics. Secondary market gains and losses are based on numerous factors, such that two identical loans with identical prices can have two different secondary market values and two loans that are different and have different pricing can have the same secondary market value. This is because factors such as time of lock, existing market conditions, and the location of the secured property, factors that have nothing to do with individual loan terms, affect secondary market value.

12. **Manager who is also a loan originator.** Does it affect the treatment of managerial compensation if a manager also originates some loans? Some branch managers only manage an office and do not originate loans, while other branch managers both act as loan originators and have management responsibilities. The latter branch managers receive compensation as a loan originator for each loan originated, and also receive compensation based on the production of the entire branch.

A. **Fed Response** - Yes. If a manager originates loans, then the manager cannot receive compensation based on loan terms, even if such compensation would be limited to loans not originated by the manager. Being a loan originator subjects all compensation received by the manager to the rule, even compensation received in the manager's capacity as manager. The manager, however, like other originators, can receive a fixed percentage amount of all loans originated.

- B. **MBA Proposed Response-** If a manager originates a *de minimis* number of loans (less than six) he or she is still treated as a managerial employee and is not subject to the restrictions of the rule regarding compensation.

If more than a *de minimis* number of loans are originated by a manager and managerial compensation is based on individual loan terms, then the loans originated by the manager must be excluded from the calculation of managerial compensation. If managerial compensation is not based on individual loan terms, then loans originated by the manager may be included in the calculation of the managerial compensation.

The determination of compensation based on the aggregate secondary market value of loans would not be compensation based on loan terms. As noted above, secondary market gains and losses are based on numerous factors, such that two identical loans with identical prices can have two different secondary market values and two loans that are different and have different pricing can have the same secondary market value. This is because factors such as time of lock, existing market conditions, and the location of the secured property, factors that have nothing to do with individual loan terms, affect secondary market value.

13. **Compensation based on profit.** May employee loan originators generally or of a certain branch or group in particular be compensated in whole or part based on profit during a particular period attributable to the branch or group. Profit is determined based on standard accounting methods to calculate revenue and expenses of the branch or group during the applicable period.

- A. **Fed Response -** No. Profit includes amounts due to the rates and terms of loans and cannot be a basis for originator compensation.
- B. **MBA Proposed Response -** Yes. It is reasonable for businesses to compensate based on profits. Moreover, the calculation of profit would be based on various factors, including secondary market gains/losses, direct expenses, and allocated expenses (such as allocated overhead). Secondary market gains and losses are based on numerous factors including the rate or terms of loans. However, two identical loans with identical prices can have two different secondary market values and two loans that are different and have different pricing can have the same secondary market value. This is because factors such as time of lock, existing market conditions, and the location of the secured property affect secondary market value. Thus, compensation of loan originators in the branch or group based in whole or part on profit of the company, branch or group includes far more than individual loan terms and is permissible.

14. **Minimum number of originators compensated based on profit.** Are there a minimum number of loan originators for a branch or group that would allow compensation based in whole or part on profit?

- A. **Fed Response -** No. Compensation to originators based on profits of a branch is problematic no matter what the number. Were such compensation permissible, it could lead to net branches of one individual to circumvent the restrictions of the rule.
- B. **MBA Proposed Response -** Yes. Compensation can be based on profits of a branch if there are a sufficient group of originators in the branch, for example, more than five.

Compensation of loan originators in the branch or group based in whole or part on profit of the branch or group is sufficiently distant from individual loan terms.

15. **Varying compensation between two subsidiaries.** Subsidiary A is a retail prime loan creditor and Subsidiary B is retail near prime loan creditor. Loan originators for Subsidiary A only work on and receive compensation for loans for Subsidiary A and loan originators for Subsidiary B only work on and receive compensation for loans for Subsidiary B. Can Subsidiary A and Subsidiary B have different commission structures for their respective loan originators?

A. **Fed Response** - Yes. The employees of each Subsidiary may originate loans only for their respective Subsidiary and, thus, their compensation would not vary based on a loan being a prime loan or a near prime loan.

16. **Varying compensation based on geographic area.** In a rural area, because of lower loan volume, it is not economically feasible to lend unless loans are priced higher than in areas with more significant lending volume. To encourage loan originators to originate loans in the rural area can a higher commission be paid to loan originators for loans originated in the rural area than for loans originated in areas with more significant lending volume?

A. **Fed Response** - Yes. Providing for different compensation in an area because of costs is recognized in Commentary Section 226.36(d) (i)-3.viii as a permitted basis to vary compensation. Further, the Board notes in the supplementary information that it believes the ability to vary compensation based on the costs of origination is sufficient to address geographical differences.

17. **Varying compensation for CRA loans.** May a creditor pay greater compensation to incent originators to make CRA loans?

A. **Fed Response** - No. Page 58523 of the supplementary information in the *Federal Register* notice indicates:

“Some commenters also urged the Board to permit higher compensation for certain loan types, for example, small loans, loans under special programs that assist first-time home-buyers and low- or moderate income consumers, and loans that satisfy the creditor’s obligations under the Community Reinvestment Act (CRA). As discussed above, creditors can encourage originators to make small loans as well as large loans by setting a minimum and maximum payment for each loan if they compensate loan originators a fixed percentage of the amount of credit extended. See comment 36(d) (1)–9. The Board believes, however, that allowing compensation to vary with loan type, such as loans eligible for consideration under the CRA, would permit unfair compensation practices to persist in loan programs offered to consumers who may be more vulnerable to such practices.”

B. **MBA Proposed Response** - Yes. We note that the quoted language was in the supplementary information and not the rule itself. Where there are quantifiable differences in costs associated with CRA vs. non-CRA loans based on average time and cost determinations, these costs can be reflected in originator compensation. See answer to question 2 above. Moreover, consistent with the Board’s permitting a minimum fee to incent origination of smaller loans, a fee to incent CRA loans should also be permissible. The use of a minimum fee alone will not work for all CRA loans and

should not need to. Incentives such as these are not based on loan terms or conditions. We also note that it is common with state bond and similar programs that there are significant limitations on the fees and interest rates that may be charged. If a creditor is not able to establish expenses for such a loan, including loan originator compensation at a different level because of these limitations, a creditor may not be able to make the loan.

18. Frequency of lowered prices as a compensation factor. A lender permits loan officers to lower prices on loans for various reasons, including meeting competition and customer relationship issues, subject to loan level and aggregate limitations. The compensation of the originator does not vary when prices are lowered and is based on loan amount. If a loan officer exceeds the permitted levels for lowering prices (i.e., fails to comply with company policy), can this be taken into consideration in a performance review to determine the loan originator's commission for an upcoming period?

- A. **Fed Response** - No. Such action may become subterfuge for compensating an originator based on the terms or conditions of a loan.
- B. **MBA Proposed Response** - The failure of the loan officer to comply with the creditor's policies may be taken into account during a periodic review in which the loan officer's compensation for the next period is determined. Such action does not amount to compensation based on loan terms. Moreover, unless the creditor can take a violation of its policies into account in determining compensation, the only choices available to enforce creditor policy may be to discipline or dismiss the loan officer. See response to Question 2.

19. Treatment of affiliate fees when party brokers a loan. For purposes of the rule, (a) affiliates are treated as a single person, and (b) compensation does not include *bona fide* and reasonable third party charges not retained by the loan originator? In situations in which a lender acts as a mortgage broker and, thus, is a loan originator for purposes of the rule, if the party has an affiliated settlement service provider, such as a title company, are the *bona fide* and reasonable charges received by the affiliated settlement service provider considered part of the loan originator compensation?

- A. **Fed Response** - No. The reason for treating affiliates as a single person is to avoid attempts to circumvent the rule by allowing a company to set up two separate companies with different commission structures and permitting its loan officers to deliver loans to either company. This is addressed in Commentary Section 226.36(d) (3)-1. This concern is not presented when a loan originator has an affiliated settlement service provider, because to be excluded from compensation under the rule the fees of the provider for the settlement service must (a) not be retained by the loan originator and (b) be *bona fide* and reasonable. The *bona fide* and reasonable requirement is sufficient to address any concern that the loan originator may seek to receive compensation by having its affiliate charge higher fees for its settlement services.

20. Loan originator reductions in rates without compensation based on terms. May a creditor permit certain loan originators to establish rate and point combinations for loans below the creditor's standard rate and point combinations without first seeking approval of a supervisor, subject to a limits on the amount per loan and the total amount per loans within given period (such as no more than Y basis points per any individual loan and no more than an aggregate of Z basis points per all loans during a quarter)? This is done to meet

competition. The compensation of the loan originators would not vary based on whether or not the rate and points established for a loan was below the creditor's standard rate and point combinations.

A. **Fed Response** - Yes. As long as a loan originator's compensation does not vary based on whether or not the rate and points established for a loan is below the creditor's standard rate and point combinations, certain loan originators may be permitted to establish rate and point combinations for loans that are below the creditor's standard rate and point combinations.

21. **Loan originator payment of third party fees.** May a loan originator pay some or all of the third party fees of a consumer or otherwise credit the consumer from a premium rate or out of his own pocket?

A. **Fed Response** - No. The rule prohibits overages and underages tied to terms including rate. The Board has concluded that if it did not prohibit lowering of loan originator compensation, the industry may establish high prices/compensation amounts, and then lower prices and compensation amounts for borrowers who negotiated. The Board views an originator's agreement to reduce compensation to pay fees as essentially the same as an underage where loan originator compensation is lowered.

B. **MBA Proposed Response** - Yes. It may be a better business model for an originator, particularly a broker, to pay third party fees. Moreover, as long as the originator is not compensated based on the terms of a loan, it is beneficial to a consumer to have an originator have the ability to absorb part of the consumer's costs or otherwise provide a credit to the consumer.

22. **Channel.** Can the compensation paid to loan originators vary based on how the loan application was produced? For example, a lender may engage in extensive marketing to develop leads through a website and/or toll free number. Loan originators employed by the lender receive the leads, and also are free to develop their own leads through avenues outside of the marketing conducted by the lender. Can a lender establish different commission structures for loans that result from leads generated by the lender and for loans that result from leads that a loan officer generates? Assume for purposes of the example that the same types of loans can be made regardless of how the lead for the loan is generated.

A. **Fed Response** - Yes. To the extent differences in a lender's costs exist depending on how loans are produced, they can be reflected in differing compensation to the originator.

23. **Reduction in broker compensation to avoid high cost loan.** A broker submits a loan application to a creditor, and has agreed to receive its standard compensation that will be paid by the creditor. The creditor reviews the application and determines that the standard broker compensation and standard creditor fees will result in the loan triggering one or more high cost loan laws, and the creditor does not make loans subject to the laws. May the broker reduce its standard compensation to avoid triggering high cost loan laws?

A. **Fed Response** - No. This amounts to the broker varying its compensation.

B. **MBA Proposed Response** - Yes. In this situation if the broker cannot reduce its compensation, the creditor effectively would be forced to forgo standard fees and/or pay third party fees (and potentially incur a loss) or reject the application from the broker. The reduction of the broker's compensation in this situation is not a variance in compensation based on loan terms that the Board seeks to prohibit with the rule.

24. **Reduction in compensation and credit to borrower.** Same facts as the prior question, except that the broker will receive its standard compensation and provide a credit to the borrower to pay some of the creditor's standard fees to avoid triggering a high cost loan law. Is this permissible?

A. **Fed Response** - No. This amounts to the broker varying its compensation.

B. **MBA Proposed Response** - Yes. In this situation if the broker cannot pay certain of the borrower's fees (or reduce its compensation), the creditor effectively would be forced to either forego standard fees and/or pay third party fees (and potentially incur a loss) or reject the application from the broker. The payment of certain fees by the broker in this situation is not a variance in compensation based on loan terms that the Board seeks to prohibit with the rule.

STEERING/SAFE HARBOR ISSUES

25. **Lowest interest rate.** What constitutes a loan with the "lowest interest rate" for purposes of the safe harbor provisions? Is this achieved by the loan with the lowest par rate or the lowest note rate notwithstanding that several discount points will be charged to the consumer for the rate?

A. **Fed Response** - For purpose of the safe harbor, the loan with the lowest interest rate is the loan with the lowest par rate available to the originator based on a published rate sheet or other document regardless of whether discount points are charged. For example, if one loan has 2.5 percent rate with 6 discount points and another loan has 3.5 percent rate and no discount points, loan with 2.5 percent rate is loan with lowest rate.

26. **Lowest total dollar amount for points or fees and discount points.** What is meant by the loan with the "lowest total dollar amount for origination points or fees and discount points?" Would a loan meet this requirement if it is way above par and carries a high note rate but has several negative discount points to make it a "no cost" loan (or even gives the borrower a refund at closing)?

A. **Fed Response** - The loan with the lowest combination of origination points, fees and discount points is the loan with lowest amount no matter what the rate.

27. **Evidence of compliance.** Should a mortgage broker evidence its compliance with the safe harbor provisions by providing a written disclosure to the consumer specifying the three loan choices available and that also would require the consumer to specify which loan he or she chose and sign the form?

- A. **Fed Response** - The Board is not compliance counsel and will not advise on how best to comply.
 - B. **MBA Proposed Response** - A mortgage broker should demonstrate its compliance with the safe harbor through documentation. The Board is not requiring a disclosure as part of documentation but such a disclosure is not in any way precluded by the rule.
28. **Creditor not liable.** It is practically impossible for a lender to know whether a broker has in fact complied with the anti-steering provision. Does the Board regard creditors as liable for an originator's violation of the anti-steering provisions?
- A. **Fed Response** - No. A creditor is not liable for violation of 226.36 (e)(1). That section applies to originators. The section prohibits an originator, particularly a mortgage broker or mortgage broker loan originator, from directing or steering a consumer to consummate a transaction based on the fact that the loan originator would greater compensation for that transaction as compared to other transactions, unless the transaction is in the consumer's interest. By its terms, the section does not apply to creditors and make them liable for originator/mortgage broker steering.

RESPA - TILA QUESTIONS

29. **Charging fees to loan originator based on failure to follow policy.** May a creditor charge fees to a loan originator by deducting the fees from the compensation due the loan originator when the loan originator fails to follow the creditor's policy and, as a result, the creditor is not able to impose fees on the consumer under RESPA, which it would otherwise impose?
- A. **Fed Response** - No. The Board views this as a variation in pricing or a concession akin to an underage that would be impermissible. However, the creditor can consider the error in resetting compensation to the creditor going forward assuming such reset considers a reasonable period of time (see above).
 - B. **MBA Proposed Response** - Yes. If a loan originator fails to include the proper fees under a creditor's policy in the Good Faith Estimate and, because of the new RESPA rules, the creditor is not able to modify the Good Faith Estimate to impose the fees on the consumer, then the creditor may properly charge the fees to the loan originator by deducting the fees from the compensation otherwise due to the loan originator. This does not constitute compensation based on loan terms that the Board rule is intended to prohibit. Rather, the purpose is to promote compliance with the creditor's policies. If the creditor could not offset compensation to the loan originator in such a situation, the Board rule would effectively force creditors to choose between forgoing standard fees (and potentially incurring a loss) or rejecting an application from a broker or denying a loan originated by a loan officer employee because it was not economically prudent to make the loan.

The creditor would not have an effective option of considering the noncompliance and reducing the originator's compensation in the future. A mortgage broker simply would cease delivering loans to the creditor.

30. **Broker provides credit to cure tolerance violation.** A broker makes one or more mistakes in a Good Faith Estimate by improperly excluding certain fees and/or including fees at amounts that are below the correct amounts, and because of the tolerances under RESPA, the Good Faith Estimate cannot be revised to add the excluded fees or increase the fees that were disclosed at amounts lower than the correct amounts. Can the broker provide a credit to the consumer at closing to cover the excluded fees or improperly disclosed fees, which is a permissible method under RESPA to cure what otherwise would be a tolerance violation? (In short, under the RESPA rules a creditor may not be able to charge the borrower either third party fees omitted from the Good Faith Estimate or an amount for third party fees that is higher than the amount disclosed in the Good Faith Estimate. Therefore, under RESPA, at closing the lender and/or broker must pay the fees to avoid a tolerance violation.)
- A. **Fed Response** - No. A broker may not adjust its compensation in this manner. The Board regards this as similar to a pricing concession which may not vary per loan. However, the creditor can consider the error in resetting compensation to the originator for future loans.
- B. **MBA Proposed Response** - Yes. This is similar to the prior question. If the broker is not able to cure the tolerance violation by providing a credit consistent with RESPA, then the creditor effectively would be forced to choose between having to pay the fees because of the broker's error (and potentially incurring a loss) or rejecting the application from the broker. The provision of such a credit does not result in compensation based on loan terms that the Board rule is intended to prohibit. Rather, the broker simply is correcting an error it made in a manner that is consistent with RESPA. The Board does not want to make RESPA compliance more difficult.
31. **RESPA Credit.** Under RESPA, any credit provided by the lender is first applied to the creditor's and broker's origination charges, and then any remainder is applied to third party charges. If a consumer agrees to pay the mortgage broker and lender directly, and asks the lender to pay some or all third party charges, the RESPA documents will reflect the credit from the lender as paying the lender's and broker's origination charges. Is the RESPA treatment of charges and credits disregarded in all respects for purposes of the loan originator compensation rule?
- A. **Possible Fed Response** - Yes. The treatment of charges and credits for RESPA purposes has no bearing on the loan originator compensation rule. In this situation, for purposes of the loan originator compensation rule, the lender would be considered to have paid the third party charges and the consumer would be considered to have paid the broker's and creditor's charges.

IMPLEMENTATION ISSUES

32. **Delayed effective date.** Would the Board consider delaying the effective date of this rule until the Dodd-Frank originator compensation provisions are implemented?
- A. **Fed Response** - No. As the Board stated in the preamble to this rule, the Board believes that the Congress was aware of the Board's proposal and that in enacting TILA Section 129B(c), the Congress sought to codify the Board's proposed prohibitions while

expanding them in some respects and making other adjustments. The Board further believes that it can best effectuate the legislative purpose of Dodd-Frank by finalizing its proposal relating to loan origination compensation and steering at this time. Allowing enactment of TILA Section 129B(c) to delay final action on the Board's prior regulatory proposal would have the opposite effect intended by the legislation of allowing the continuation of practices that the Congress sought to prohibit. Through its rule and in follow-up guidance the Board will work to assist compliance with the provisions of the rule which are to become effective April 1, 2011.

B. MBA Proposed Response - Yes. There are several differences between Dodd-Frank and the Board's approach that support withdrawal of the rule and a new rulemaking to reconcile these differences. A few of the examples include that Dodd-Frank, prohibits several specific types of steering including steering a consumer from a favorable loan to a less favorable loan, regardless of the compensation of the loan originator or creditor. The Board rule, however, takes a different view of steering, first by restricting steering based on compensation and then by interpreting its loan terms compensation prohibition as an anti-steering rule, which results in many of the issues here that are not presented by Dodd-Frank. Also while Dodd-Frank prohibits compensation that varies based on the terms of the loan, it allows compensation to vary based on the principal amount of the loan without any conditions. In contrast, the Board rule only permits the use of fixed percentage of the loan amount, subject to optional minimum and maximum dollar amounts that also must be fixed. While we believe these differences would support withdrawal of the rule and a new rulemaking to reconcile these differences, at the very least, written guidance should be mindful of the future Dodd-Frank rulemaking.

33. No new provisions prior for April 1 - Does the Board plan to implement the Dodd-Frank loan originator compensation provisions on an interim or final basis so that they would also be effective April 1, 2011?

A. Fed Response - The Board will not consider implementation issues.

B. MBA Proposed Response - No. Considering that April 1, 2011, is fast approaching, the Board will not promulgate additional requirements on loan originator compensation to be effective that date. It will, however, provide written and verbal guidance to assist implementation.

NEWEST QUESTIONS

34. Bonus tied to factors. As indicated in the response to Question 2, Board staff has confirmed that factors such as early payment default or early payoff, quality of loan files, and percentage of applications that result in closed loans, can be used to determine the compensation of a loan originator. This was discussed in the context of reviewing results during a prior period when establishing compensation for an upcoming period. Can these factors, and other non-loan term factors, be used to qualify for a bonus for performance in a prior period? For example, if the number of early payment defaults is below a specified level, the error rate in loan files is below a specified level and the percentage of applications that result in closed loans is above a specified level, could additional compensation not based on loan terms, such as 20 basis points of total volume, be paid?

A. **MBA Proposed Response** - Yes. These factors can be used to arrive at compensation going forward and bonuses reflecting performance.

35. **Application of rule to single person company.** In many cases a mortgage broker is a single individual. While that individual is a loan originator, he or she also is the owner of the brokerage, regardless of the legal form of the company. As long as the compensation received on each loan by the brokerage firm is not based on the terms of the respective loan, it appears that would constitute compliance with the Board rule, even though in the end the net compensation that the individual will receive will equate with the net profit from the brokerage firm. Is that true?

A. **MBA Proposed Response** - Yes, under these circumstances.

36. **Existing customer.** The Board rule permits varying compensation based on whether or not a borrower is an "existing customer." If a lender makes a loan, does not continue to service the loan and the consumer later refinances the loan with the lender, can the lender treat that consumer as an existing customer based on having made the existing loan (which likely will be the reason that the consumer returns to the lender). Does it make a difference if the lender continues to service the loan even though it sold the loan?

A. **MBA Proposed Response** - Yes. "Existing customer" should be interpreted broadly to include a consumer that has been associated with a creditor or a mortgage brokerage in some manner. Examples of an existing customer include a consumer for whom a creditor or broker previously arranged a loan; a consumer to whom a creditor previously made a loan; a consumer whose loan a creditor presently services; or a consumer with a deposit, lending, or other banking, trust, advisory or other business relationship with a depository institution, other creditor, broker or its affiliates, or an affiliate of any of them.

37. **Hourly versus commission.** Can a creditor pay employees dedicated to making CRA loans on an hourly basis, or hourly basis plus a small commission that is a fixed percentage of the loan amount, and pay employees who originate other loans on a commission basis only?

A. **MBA Proposed Response** - As long as differences in compensation can be justified by differences in origination costs and time, whether computed on an average or per loan basis, they are permissible.

38. **Loan originator.** The Board rule defines the term "loan originator" as follows:

"For purposes of this section, the term "loan originator" means with respect to a particular transaction, a person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term "loan originator" includes an employee of the creditor if the employee meets this definition. The term "loan originator" includes the creditor only if the creditor does not provide the funds for the transaction at consummation out of the creditor's own resources, including drawing on a *bona fide* warehouse line of credit, or out of deposits held by the creditor."

If a manager engages in any direct communication with a consumer, but does not arrange, negotiate or otherwise obtain an extension of credit (i.e., the actual origination functions are

handled by other individuals), may the manager still be treated as a manager and not a loan originator? May a manager approve aspects of a deal and also remain a manager?

A. **MBA Proposed Response** - Yes. A manager who does not arrange, negotiate or otherwise obtain an extension of credit remains a manager and may be compensated as such even if he incidentally communicates with the customer. A manager also may approve aspects of an origination in his capacity as manager and company representative and not lose his identity as a manager for purposes of compensation.

39. **Establishing origination point amount based on standard commission.** Employee loan officers take different approaches to compensation. Some elect to receive a lower amount of compensation per loan and originate more loans, while others elect to receive a higher amount of compensation per loan and originate fewer loans. For example, loan officer A may seek a commission of 0.80 percent per loan and loan officer B may seek a commission of 1.0 percent per loan. May a creditor establish a structure in which (a) for loans originated by loan officer A, the origination point is 0.80 percent and the loan officer receives the 0.80 percent as compensation, and (b) for loans originated by loan officer B, the origination point is 1.0 percent and the loan officer receives the 1.0 percent as compensation?

A. **MBA Proposed Response** - Yes. The final rule permits variation of compensation among loan originators, and in this structure the compensation of an individual loan officer would not vary based on loan terms or conditions.

40. **Minimum and maximum dollar amount.** The rule allows a creditor to establish different compensation terms for different originators, as long as compensation does not vary based on loan terms. The rule also allows a creditor to use a fixed percent commission structure, with a minimum and/or maximum dollar amount of compensation. May the minimum and/or maximum dollar amount differ among loan originators, as long as the variance is not based on loan terms?

A. **MBA Proposed Response** - Yes. A loan originator's compensation may be based on a fixed percentage of the loan amount, subject to a minimum and/or maximum dollar amount, and the fixed percentage and minimum and/or maximum dollar amount may vary between loan originators, as long as the variance is not based on loan terms.

41. **State bond limitations.** If under a state bond or similar program there are limitations on the interest rates and fees that a creditor may charge, may the loan originator compensation be established at a lower level for the loans?

A. **MBA Proposed Response** - Yes. If the lower loan originator compensation is based on rate and fee limitations under a state bond or similar program, to account for the limitations the creditor may establish the loan originator compensation at a lower level. Not permitting the creditor to establish the loan originator compensation at a lower level could result in the creditor no longer participating in the program, and is not a result intended by the rule.

42. **More Favorable Terms.** A lender decides to provide more favorable terms to certain brokers based on the quality of their submissions (the "subject brokers") and considers the following alternatives. Assume in each case the exact same loans are involved and all loan terms are the same, except for the credit or compensation addressed in the alternatives.

- a. The lender does not pay broker compensation; all broker compensation is paid by the consumer. For the subject brokers, the lender will provide better loan pricing in the form of a credit. For example, while other brokers would receive a standard rate of 5.0 percent with no points or credit, the subject brokers would receive the standard rate of 5.0 percent with a 0.25 percent credit to the borrower to be applied to third party closing costs.
 - A. **MBA Proposed Response** - This is permissible. The arrangement does not result in the variation of loan originator compensation based on loan terms. It simply is a means of varying compensation among originators which is permissible under the rule.

- b. The lender pays all broker compensation. For the subject brokers, the lender will provide better loan pricing in the form of a credit. For example, while other brokers would receive a standard rate of 5.5 percent with a 1.0 percent credit to pay the broker's compensation, the subject brokers would receive the standard rate of 5.5 percent with a 1.0 percent credit to pay the broker's compensation and a 0.25 percent credit to the borrower to be applied to third party closing costs.
 - A. **MBA Proposed Response** - This is permissible. The arrangement does not result in the variation of loan originator compensation based on loan terms. . It simply is a means of varying compensation among originators which is permissible under the rule.

- c. The lender pays all broker compensation. For the subject brokers, the lender will provide better loan pricing in the form of a credit and the lender does not specify how the credit must be allocated by the subject brokers to their compensation or to the consumer. For example, while other brokers would receive a standard rate of 5.5 percent with a 1.0 percent credit to pay the broker's compensation, the subject brokers would receive the standard rate of 5.5 percent with a 1.25 percent credit.
 - A. **MBA Proposed Response** - Varying compensation among originators is permissible under the rule and accordingly the lender would be free to simply give the subject brokers the 1.25 percent credit and the other brokers 1.0 percent.