Compensation Rule Questions and Answers

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The notes below highlight some of the important questions and answers discussed during our recent compensation rule webinar.

This handout is for informational purposes only. It provides an overview of some of the federal regulations that may affect mortgage loan originations. It is not intended to constitute – and is not a substitute for – legal or other advice.

I. Compensating LOs and Employees

Q: Under what circumstance can a producing Branch Manager be paid on the profit of a branch?

A: The devil truly is in the details with Branch Managers. The Fed has been asked to clarify this and has said that if a Branch Manager originates one loan, then he/she is classified as an LO. Once you’re a LO, all of your compensation is based on this rule. There are ways to continue to make it interesting for producing Branch Managers, but paying them an override is not going to be possible under this rule. The best way to proceed is to discuss your specific situation with legal counsel.

Q: Do LOs have to be paid either a salary or hourly wage?

A: If a company is paid by consumers, then they can only pay LOs an hourly or salary wage. Now, if the company is paid by consumers on some loans and by lenders on others, then the compensation plan must take that into account. There are ways to address this in the compensation plan, such as considering that you are limited by salary or hourly wage if paid by the consumer. You’ll want to pay careful attention to the regulation and make sure that your compensation plan is structured in such a way that it clearly complies with the rule.
Q: Can the broker of record filter compensation to others?

A: Other team members may not be mentioned in the rule because they’re not technically LOs. But you still must be careful because you may violate another part of the rule. A good perspective to keep in mind is that other employees or team members who work with an LO are considered employees of the company and, therefore, should be compensated by the company.

Q: Does the rule require that LOs be paid by basis points based on the loan amount, rather than a percentage of the commission brought in?

A: Yes, this is the rule. Paying on the loan amount is allowed, but paying on the commission would be a term and condition – and you can’t compensate based on that. That said, most lenders are trying to structure their compensation so that it is compliant and compensates LOs very similarly to the past. They just get to that compensation amount with a different structure than before.

Q: Can one LO split commission with another team member?

A: This is a concern from a couple different perspectives. First, as stated above, if the other person is not an LO, then he/she is not subject to the rule because he/she should be paid by the company.

Second, if the other person is an LO, sharing compensation would be a concern because the two LOs may be determining how they share loan-by-loan basis, which would lead to changes in sharing – and that violates the rule. The best advice is to compensate each LO based on the compensation plan, rather than getting tangled in the complexity of this unclear area. Keep it simple.
Q: How often can LOs (not banks, but actual LOs) choose to change their compensation?

A: The bottom line is that it shouldn’t be up to LOs when they want to change their compensation plan or pick a different plan. It’s up to banks or the employers to offer plans – and then to inform LOs what the plans are, what plan the LO is under, and when plans are changing. That said, many employers will not spell out specifically when they will revise the plans they offer; instead they will state that they reserve the right to amend from time to time.

II. Different Types of Loans

Q: Can you offer different compensation plans on brokered deal versus in-house deals?

A: Lenders can offer different compensation loans generated by in-house leads compared to LO-generated loans. What you want to be careful about, however, is that the price the consumer receives from an in-house lead is not significantly different than the price a consumer receives on a LO-generated loan. In other words, the LO’s compensation can be different, but the pricing should not be significantly different. Lenders need to be careful and police their pricing.

Q: Does compensation have to be the same on both correspondent and brokered loans?

A: The rule’s not clear on this, but an argument can be made that there is less work to be done on one channel, which would justify a difference in the compensation. But you need to make sure you can make the case (1) why it’s different and (2) that it was in the consumer’s best interest.

Another thing to consider is that lenders wouldn’t want to broker out loans that they could make. They should only broker out loans they cannot make.
Q: Can you offer different compensation plans on different loan types, such as FHA versus conventional?

A: Although the rule doesn’t clearly state an answer one way or the other, such a difference may be possible. In fact, in the public webinar held by the Fed, attorneys indicated that creditors may be able to demonstrate that there’s a legitimate basis for differing compensation between two different loan programs. However, the burden is on the creditor to make this case.

In other words, you have to justify the different pay structures – and that means the lender needs to show that the difference is not based on terms/conditions, but on other legitimate factors such as length of time required.

An informal response on the rule indicated that it may be possible to document legitimate differences between FHA and conventional loans, and anecdotal evidence suggests the length of time between conventional and FHA is significant.

The bottom line is that you may be able to pay differently, if you can justify the difference based on legitimate factors (such as time to produce the loan) and if the other terms/conditions were the same.

Q: Will some standards eventually come to the surface for handling different types of loans?

A: There are so many different details to consider in any given situation. The fact is, it’s not clear that it will become acceptable to differentiate between a class of loans within a shop, let alone within the industry. Rather than focus on standards, you are better off coming up with a compensation plan that is the same for all different types of loans.

A simple aspect to focus on is: You can pay different LOs differently, but you can’t pay the same LO differently based on the loan type.
III. Following the Rules

Q: Do loans for investment properties fall under the rules?

A: You need to be careful, especially with rental properties or vacation homes. But if it’s truly an investment property (which is considered a business purpose loan), it would not be subject. This can really be a complex issue, however, so you need to look closely with legal counsel at the purpose of the loan in the application as well as occupancy details.

Q: What should be disclosed as the lowest safe harbor option?

A: Like many parts to the rule, there isn’t a published safe harbor form. The rule describes what has to be in there. So you must show the loan with the lowest rate – but it doesn’t require you show details like closing costs, cost to buy down, etc.

The problem with disclosing too much is that no good deed goes unpublished. Some are trying to require more and may get into trouble by disclosing more than required.

Q: Do individual LOs have the right to price their own loans or is that set by the lender?

A: It really depends on the originating company. Best bet is to talk to your manager. But giving the LO the ability to really do as they see fit would likely be a recipe for disaster. Practical answer is that companies may allow some discretion within parameters or with permission, but not given true freedom.

Reminder...

The proper interpretation of laws and regulations can be highly dependent upon particular facts, which may reveal exceptions or differing interpretations. You should always consult appropriate counsel or other advisers, taking into account your relevant circumstances and issues.