Thursday, March 3, 2011

FRB: Mangles Affiliate Compensation

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 if the confusion caused by the FRB's lack of substantive guidance regarding TILA loan originator compensation were not enough for the industry to absorb, the FRB now sallies into adversely affecting another market segment of the residential real estate finance industry: affiliates.

It is one thing for the FRB to find regulatory means to implement Dodd-Frank; however, it is unacceptable to discombobulate affiliate relationships by an overreaching interpretation regarding loan originator compensation in a way that amplifies the confusion.

Action is eloquence. Coriolanus, Shakespeare

While so many market participants are rightfully concerned with the consequences following April 1, 2011, the effective date of the new TILA loan originator compensation requirements, I want to bring your attention to the FRB's stance with respect to affiliates, a core business relationship feature, and how affiliate compensation is being imperiled by the forthcoming TILA revisions.

Recently, **several leading industry organizations announced that they had sent a joint letter to the FRB (Letter).** The Letter - which is dated February 28, 2011 and addressed to Ben Bernanke, FRB Chairman, and Sandra Braunstein, Director of the FRB's Consumer and Community Affairs Division - contests the FRB staff's interpretation and offers two reasonable alternatives.

Some media sources have mentioned the Letter, but they have provided scant information about it.

So I reached out to a trusted friend and leader in one of the Letter's sponsoring organizations, and was graciously given a copy. In my view, the points raised in the Letter deserve to be more fully known by the public, and the views therein expressed should be added to the other industry requests, previously placed with the FRB, to either delay the aforementioned effective date or provide credible, unambiguous, and supportable guidance prior to the effective date. A brief synopsis follows.

But before I discuss certain salient issues, permit me to list the signatories to the Letter:

- Community Mortgage Banking Project (CMBP)
- Consumer Mortgage Coalition (CMC)
- National Association of Homebuilders (NAHB)
- National Association of Mortgage Brokers (NAMB)
- National Association of REALTORS (NAR)
- Real Estate Services Providers Council, Inc. (RESPRO)
- The Realty Alliance

These organizations are among the most prominent in the residential real estate finance industry, with substantial membership, and have dedicated themselves for many years to providing support, guidance, and advocacy to industry participants and the public.

The first mortgage risk management firm in the USA devoted only to residential mortgage compliance.

Our professionals and support staff have extensive experience.

True is it that we have seen better days. As You Like It, Shakespeare

The FRB's view can be stated, as follows: (1) the loan originator compensation rule prohibits payment to originators based on loan terms or conditions, and, further, (2) it prohibits "dual compensation" of loan originators, such as compensation received by entities for brokering loans to loan originators, and (3) an "affiliate" is a single person; therefore, as such and by extension, (4) an affiliate is subject to the "dual compensation" prohibition.

I have already discussed elsewhere this "dual compensation" dilemma.

A clever sleight of hand is taking place here. By extending dual compensation to affiliates through the "single person" concept, the FRB maintains a certain consistency with respect to the final rule. Here's the logic: just as the FRB is attempting to prevent "circumvention" of the final rule by prohibiting a producing branch manager from participating in profits because they are derived from the rates and terms of loans, thus cannot be a basis for loan originator compensation, by extension, the same criteria can be applied to other participants in the loan origination, including affiliates, and for much the same reasons. I know that's convoluted, but it is what it is!

FRB's Scenario

Here is one "circumvention" scenario that the FRB uses:

> [T]he rule would be circumvented, for example, if a parent company that has two mortgage lending subsidiaries could arrange to pay a loan originator greater compensation on higher rate loans offered by subsidiary A than the compensation it would pay the same originator for a lower rate loan made by subsidiary "B". To address this issue, the Board treats such subsidiaries of the parent company as a single person so that if a loan originator is able to deliver loan (sic) to both subsidiaries, they must compensate the loan originator in the same manner. Accordingly, if a loan originator delivers a loan to subsidiary B and the interest rate is 8 percent, the originator must receive the same compensation that would have been paid by subsidiary A for a loan with a rate of either 7 or 8 percent.

Our remedies oft in ourselves do lie. All's Well That Ends Well, Shakespeare

The Letter states that FRB staff has decided "they not only would consider all lending affiliates of an originator as one person as stated in the rule, but that they also would consider fees paid to a mortgage company's affiliated real estate brokerage and title/settlement service companies as one person, **meaning that fees paid for the fair market value of services performed by these affiliated companies could be considered as loan compensation."** (My emphasis)

The organizations allege that the FRB's interpretation would "for no justifiable reason" adversely impact "the use of a successful and long-established affiliated business model employed by many members of the undersigned associations that offers consumers one-stop shopping." The Letter states the fact that the "one-stop shopping" concept was contemplated by Congress in a 1983 amendment to RESPA.

Now, for some background, we must take a very cursory, but necessary digression from TILA (FRB's domain) to RESPA (HUD's domain). RESPA is primarily a disclosure and anti-kickback statute. With respect to anti-kickbacks, Section 8 of RESPA makes it a crime for settlement service providers to pay and for real estate brokers to receive fees for the referral of settlement service business.

RESPA provides an exemption to affiliated business arrangements (ABAs) that conform to specific guidelines. An ABA is a special combination of two or more legal entities which agree to carry out a single business enterprise for profit, and for which purpose they combine their property, money, effects, skill and knowledge. Partners to an ABA must satisfy, among other things, a multi-prong, safe-harbor test under Section 8(c)(4) of RESPA to get the exemption. One of the safe harbor prongs, for instance, requires that a partner's share of the profits corresponds to its ownership interest and payments may not be conditioned on the number of loans referred to the ABA.

Returning to TILA, it is significant that the Letter contends that "under the [FRB] staff's interpretation, *bona fide* and reasonable compensation paid by a seller/buyer for real estate brokerage services to that firm would be considered ... as direct compensation paid to the mortgage company, which would **mean that the real estate broker's affiliated mortgage company could not broker any loans and be paid for such brokerage activity by the lender without violating the dual source compensation prohibition."** (My emphasis)

Out, damn'd spot! Out, I say!-One; two: why, then 'tis time to do't. Macbeth, Shakespeare

Here's the crux of the matter:

1) Dodd-Frank expressly exempts real estate brokers from the definition of loan originator. The interpretation of "affiliate" goes far beyond Dodd-Frank by considering real estate

brokerage fees to be loan originator compensation, because Dodd-Frank specifically exempts real estate brokers from being considered a loan originator. So "to the extent that Dodd-Frank treats title agencies in a manner similar to that contained in the Board's the final rule, [Dodd-Frank] permits exemptions from these statutory rules." Thus, "when 'third party' *bona fide* reasonable charges were declared to be exempt, affiliates, by definition, would be excluded from treatment as a 'third party' because of a common ownership interest with the creditor/originator."

2) Mortgage companies often have title agency affiliates and, if the FRB's interpretation holds, then if a buyer uses the mortgage company's title affiliate and if either the borrower or the seller pays part of the title or closing costs to the title affiliate, the lender with whom the title agent is affiliated could not broker any loans for payment by the lender without violating the "dual compensation" prohibition.

Here's the organizations' view:

1) Title insurance rates in forty-four states are set by the states, approved by the states, or are filed with the states. The established, approved, and/or filed rates are the rates that have to be charged. "For the overwhelming majority of transactions, there is no risk that an affiliated lender could circumvent the final rule by inflating the title rates."

2) Regarding third party charges, the FRB holds that the term "compensation" includes "amounts retained by the loan originator, but does not include amounts that the loan originator receives as payments for *bona fide,* third party charges, such as title insurance. . . ." So, under the FRB's interpretation an "affiliate" does not qualify as a third party pursuant to this exemption. Even though in 90% of transactions the title fees of independent companies and affiliated companies are restricted or filed as a matter of state law, the FRB has "adopted an interpretation that in effect would preclude mortgage companies from brokering loans when the consumer uses an affiliated title company but permits it when the consumer uses a non-affiliated company that charges the exact same filed rate." *Bona fide* reasonable title charges of title affiliates would not be exempted, even if they are the same as *bona fide* reasonable charges of unaffiliated title companies.

3) The FRB's interpretation of the term "affiliate" would seriously disadvantage some real estate brokerage firms or title companies that are part of corporate holding companies, entities that may own other businesses such as utilities and insurance companies. **Scenario:** if, at closing, it is discovered that a consumer has paid a fee to one of these insurance companies or utilities - such fee would be subsumed under the "affiliates" term vis-à-vis Dodd-Frank's "common control" definition - and the FRB's interpretation would lead to preventing the mortgage company from receiving a fee from the lender to which it brokered the loan, because "the consumer's fee to the insurance company or utility also would count as loan originator compensation."

These organizations have it exactly right: the FRB's interpretation leads to "illogical consequences."

Lenders Compliance Group

More matter with less art. Hamlet, Shakespeare

What is needed at this late date, just a few weeks before the April 1, 2011 effective date, is more substance and less rhetoric.

The above-mentioned signatories offer two resolutions, both quite reasonable, each consistent with existing law.

Solution # 1: Continue to define an "affiliate" as one person but interpret the term "third party" to include affiliates, so that the fees of third party title companies, appraisal companies, real estate brokers, et cetera (whether affiliated with the originator or not) may be exempted from loan originator compensation so long as they are *bona fide* and reasonable.

Solution # 2: Limit the definition of "affiliate" to include mortgage lending and mortgage brokering businesses, as specifically stated in the rule, but not include non-mortgage providers in that definition.

It seems to me that, with either solution, the organizations are going out of their way to resolve the situation in a manner that provides continuing stability to the real estate finance industry. The FRB should meet immediately with representatives of these organizations. Relationships that are important to a well-functioning industry now are imperiled by the lack of FRB guidance.

When this Letter is added to the previous correspondence and communications to the FRB from the SBA Office of Advocacy, the MBA, the NAIHP, the IMMAAG, and the NAMB, the situation begs for the FRB's expeditious clarification of TILA loan originator compensation revisions or a determination to delay their implementation.

If you want to read the Letter in its entirety, a copy is available in our Library.

Lenders Compliance Group

What do you think?

I would welcome your comments.
Please feel free to email me or leave your comments below.

National Law Journal

National Mortgage News

National Mortgage Professional

NMLS Users Forum

Realtor Mag

Reverse Mortgage Daily News

Reverse Review

Scotsman Guide

Labels: Affiliated Business Arrangements, Affiliates Compensation, FRB, IMMAAG, Loan Officer Compensation, Loan Originator Compensation, MBA, NAIHP, NAMB, RESPA, RESPA Section 8, SBA Office of Advocacy, TILA

Home Older Post

COMMENTS & DISCUSSIONS

Comment Box

LENDERS COMPLIANCE GROUP is the first full-service, mortgage risk management firm in the country, specializing exclusively in residential 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.

Tags | Labels | Keywords | Categories

Affiliated Business Arrangements Affiliated Service Providers Alternative Modification Borrower Eligibility CFPA compare ratio task force compare ratios Consumer Financial Protection Agency Core Compliance Credit Reports Department of Housing and Urban Development Department of Labor Employment Law Escrows Fair Labor Standards Act Fannie Mae Fannie Mae Loan Quality Initiative fha defaults Good Faith Estimate HAMP Home Affordable Modifcation Program HUD HUD-1 Settlement Statement Lending Compliance Loan Modifications Loan Officer Compensation loss mitigation Loss Mitigation Compliance Mortgage Compliance mortgage defaults Mortgage Disclosures mortgage fraud Mortgage News Mortgage Originator Compensation Permanent Modifications Prepayment Penalties real estate fraud Regulation X Regulation Z RESPA Risk Ratings Service Release Premiums Servicing Settlement Cost Booklet Settlement Service Providers Trial Modifications Truth in Lending Act Yield Spread Premiums