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ORIGINATIONPRO MORTGAGE SCHOOL

The Federal Reserve Board's Changes to Regulation Z Implementing the Loan Originator Compensation Rules

Special Guest Presenter

James Milano

WEINER BRODSKY SIDMAN KIDER PC

Dave Hershman

OriginationPro

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Dave Hershman
Top Industry Author and Speaker

- Produced almost 600 transactions in his first 18 months in the industry—including closing 60 in his 12th month;
- Run sales forces for large production organizations;
- Directed the sales force for the largest mortgage technology organization;
- Written seven books in the areas of finance, management, sales & marketing—including two best-sellers published by the MBA;
- Helped found a Federal Bank, serving as a board of director;
- Been a keynote speaker at hundreds of industry events

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OUR GOALS TODAY

- Legislative/Regulatory Update
- Short Intro to OriginationPro Product Line
- Scope of the Dodd-Frank Law
- Introduction of Speaker
- Compensation: Three Rules
- Applicability
- Dodd-Frank Law Compensation

And—
Q&A

LATEST NEWS BRIEF

- MBA has filed suit against Depart of Labor regarding overtime rules. Rumor has it one trade group may be filing suit challenging Fed on the comp plan. Very little guidance from the Fed in writing.
- FHA has eliminated the use of Master Appraisal Reports for new home projects.
- FHA is in the process of extending the waiver of its anti-flipping rule for another year.
- Red Flags rule: effective December 31, 2010. More information to come on this.
- Reminder of new credit score disclosure. Relates to how much an applicant's credit scores affects their quotes and/or decision on a loan.
- Speaking of new disclosures: The Fed release interim rule requiring new TIL/mortgage program disclosures starting January 31.
- FHA issued extension of temporary waiver of new condo requirements through June 30, 2011, but does not affect expiration dates of approvals.
- Deduction for mortgage insurance extension was included in the tax compromise
- Fannie/Freddie are raising premiums for low scores & secondary financing—some lenders already charging
- FHA has not ruled on Seller Contributions as of yet. Rumor has it will come in January.
- FHA is considering changes in MIP refund policy.
- FHA has started tracking NMLS numbers.

RED FLAGS RULE

- The FTC issued this rule now effective December 31, 2010 specifying the responsibilities of lenders not only to protect the identity of the applicants, but ferret out applicants who are stealing the identities of others. The rules were promulgated under the Fair and Accurate Transactions Act
- The rule applies to financial institutions and creditors. The Rule defines a "financial institution" as: banks and any other entities that directly or indirectly hold a "transaction account" belonging to a consumer.
- Those who must comply must develop and implement an identity theft protection program. The FTC has issued these steps to developing such a program:
  - Step One – Identify relevant red flags. Identify the red flags of identity theft you're likely to come across in your business.
  - Step Two – Detect red flags. Set up procedures to detect those red flags in your day-to-day operations.
  - Step Three – Prevent and mitigate identity theft. If you spot the red flags you've identified, respond appropriately to prevent and mitigate the harm done.
  - Step Four – Update your Program. The risks of identity theft can change rapidly, so it's important to keep your Program current and educate your staff.

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- **MBS data sent to your cell phone** -- Say goodbye to surprises...when unscheduled price changes hit, you'll be the first to know, no matter where you are. In the office or on the golf course, you can beat the re-price and save your commissions!
- **Daily Market Commentary** updated all day long gives you the ammo you need to discuss market conditions with borrowers and Realtors in terms they can understand...not useless econo-babble!
- **Calendar of events** warns you of pending market volatility. The release of economic data is the #1 reason why bonds become volatile! It is crucial for you to know what data is scheduled for release, so you can advise your borrowers, Realtors, and other referral partners to make the best decisions regarding their mortgage loans.

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FINANCIAL SERVICES LEGISLATION

- The President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act 7/21.
- The law incorporates several separate new laws, including the Mortgage Reform and Anti-Predatory Lending Act which is Title XIV of the Act, and the Consumer Financial Protection Act of 2010 (Title X), which creates the new Bureau of Consumer Financial Protection, which will be an independent agency under the Fed. The Subtitles of The Mortgage Reform Act include:
  - Subtitle A: Residential Mortgage Loan Origination Standards addresses limitations on mortgage originator compensation and permissible activities
  - Subtitle B: Minimum Standards for Mortgages, adds an ability to repay standard for residential mortgage loans and additional disclosures for residential mortgage loans
  - Subtitle C adds a new definition and new requirements for high cost mortgage loans
  - Subtitle D adds a new Office of Housing Counseling under HUD and mandates changes to the mortgage information booklet given to the applicant under RESPA.
  - Subtitle E adds new obligations on loan servicers via amendments to TILA and RESPA
  - Subtitle F adds new loan appraisal requirements to replace the HVCC
  - Subtitle G adds enhancements to the HAMP program
- *Timing of Implementation:* Some provisions may be immediate but in reality the Consumer Financial Protection Bureau must be created first & then issue rules. Some rules may be introduced directly from the Fed who has already proposed some of these, such as compensation regulations. Elimination of HVCC also had a timing component—90 days.

FED COMPENSATION RULES

- Why did these rules come out so quickly after the signing of the Dodd-Frank Act?
- These are FINAL Rules that were proposed in August of 2009 and, for the most part, the language was incorporated into the Act.
- It is assumed the Fed waited to issue final rules to make sure the language in the final version of the Act did not conflict with their proposed rules
- Rules effective 4/1/11.

SPECIAL GUEST PRESENTER

JIM MILANO WBSK

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Jims focuses on federal and state regulatory compliance matters related to the financial services industry, particularly with respect to reverse mortgage lending issues. Jim is Co-General Counsel of the National Reverse Mortgage Lenders Association the national trade association supporting reverse mortgage originators, servicers, investors and their vendors, and is nationally recognized as one of the leading lawyers in the area of reverse mortgage law. He represents and advises mortgage companies, consumer finance companies, financial institutions and secondary market investors, and their settlement service provider vendors, on issues such as:

- State mortgage licensing and S.A.F.E. Act related compliance
- FHA lending programs, rules and guidelines
- Responding to federal & state regulatory audits and administrative enforcement actions
- State laws & regs concerning loan disclosures, allowable fees & prohibited practices
- Federal preemption of state lending laws
- Federal laws and regulations including, but not limited to, TILA, RESPA, ECOA, FDCPA, HMDA, FCRA, GLBA
- Implementation of the Dodd-Frank Act

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Overview

- No comp to loan officer from <u>anyone</u> else if consumer pays loan officer directly
- If anyone else pays loan officer, then no payment allowed:
  - From consumer, or
  - Based on terms/conditions of loan (with some exceptions)
- If anyone else pays loan officer, no steering consumer to close loan not in consumer's interest

What Is Covered?

- Application received by Creditor 4/1/11 or after
- Loan types: All Closed-end Consumer Loans secured by dwelling (narrow exceptions include HELOC's, vacant land, business purpose)
- Closed End Reverse Mortgages
- Most if not all Fixed Rate HECMs are Structured as Closed End Credit for Regulation Z Purposes
- Most if not all Variable Rate HECMs are Structured as Open End Credit for Regulation Z Purposes
- Payments to "Loan Originators," but NOT Payments to Entities that Are Creditors ("Secondary Market Exemption" Applies)
- Lenders Making Loans in Their Own Name with Their Own Funds Are Creditors and may sell Loans and Receive "Gain on Sale." Warehouse Lines of Credit OK, but be Careful with "True Source of Funds"

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Who is an LO?

- Person for compensation or gain (or expectation of comp or gain), arranges, negotiates or obtains extension of credit for another, but NOT creditor
- Brokers (individual or entity)
- Loan officer employees (creditors/brokers)

Rules do not apply to:

- Managers, admin staff, and others if they do not originate loans, and comp not based on whether particular loan is originated
- Servicer <u>modifying</u> a loan

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What is comp?

- Almost everything:
  - Salaries, commissions, awards, prizes
  - Fees the loan officer retains, regardless of name

Rule 1

No comp to loan officer from anyone else, if consumer pays loan officer directly

Rule 1

- If consumer pays LO directly:
  - Cannot Give – All other persons who know (or should know) of consumer- direct comp prohibited from paying LO in connection with transaction
  - Cannot Receive – All LOs prohibited from receiving any other comp in connection with transaction

What is consumer-direct compensation?

Rule One Compensation:

- Cash, payment from loan proceeds at closing
- Not consumer-direct – comp from increased interest rate, points, or fees paid to creditor which are then paid to loan officer

Rule 1 – Recap

No comp to loan officer from anyone else, if consumer pays loan officer directly

Rule 2

If non-consumer pays loan officer,
no payment based
on terms/conditions of loan

Rule 2

- What is a term/condition?
  - Interest rate/APR
  - LTV
  - Prepayment Penalty
  - Proxy for term/condition such as credit score or DTI

Rule 2: What's allowed?

- Compensation based on factors like:
  - % of loan amount fixed in advance (floor/cap permitted, but no tiers based on loan amount)
    - What is the "Loan Amount" for a Reverse Mortgage?
    - Best Answer: Maximum Claim Amount
  - Close rate–apps resulting in closed loan
  - Different comp for different LOs (Fair Lending Issue)
  - Long term performance of loans (FLSA Issue)
  - Volume (number of loans or dollar amount) (RESPA)

Rule 2: What's allowed? (cont'd)

- Comp based on factors like:
  - Legitimate business expenses like fixed overhead costs (FHA/net-branch Issue)
  - Hourly rate or salary for hours worked
  - Whether new or existing customer
  - Fixed amount per loan (e.g., $600/loan, or $1,000/loan for first 1,000 loans and $500/loan each additional loan)
  - Quality of LOs files (e.g., accuracy/completeness)

Rule 2: Can comp be changed?

- No change in comp (<u>increase or decrease</u>) allowed based on terms/conditions
- Periodic revisions allowed: Can revise comp going forward, but not based on loan’s terms/conditions

RULE 2 - RECAP

If non-consumer pays loan officer,

no payment based on terms/conditions of loan,

except % of loan amount

Rule 3

If non-consumer pays loan officer,
no steering allowed unless
in <u>consumer's interest</u>

Rule 3: Definitions

- What is “steering”?
  - Advising, counseling or otherwise influencing consumer
- What is “consumer’s interest”?
  - Compare transaction to other loans available through the loan officer
  - E.g., higher rate loan but no prepayment penalty or lower costs

Rule 3: Exceptions

- Not applicable to:
  - <u>Creditor's employees</u> if comply with prohibition on compensating based on loan terms/conditions
  - Consumer direct transactions
  - "Safe Harbor"

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Rule 3: What's the Safe Harbor?

- Presume compliance if loan officer obtains loan options from significant number of creditors with which regularly does business, and either:
  - Steers to loan with least amount of creditor-paid compensation, or
  - Presents consumer with options satisfying 3 criteria for each type of transaction of interest to consumer (e.g., fixed, ARM, reverse)

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Rule 3: What Three Criteria?

1. Lowest rate
2. Lowest rate, and no "risky features"
   - E.g., negative amortization, prepayment penalty, interest-only, balloon within 7 yrs., demand feature, or shared equity/appreciation
3. Lowest total dollar amount for origination points or fees and discount points

Rule 3: What's not required?

- Creditor/LO not required to:
  - Meet safe harbor
  - Establish new relationships
  - Inform consumer of transactions for which don't likely qualify

Rule 3 – Recap

If non-consumer pays loan officer,

no steering permitted, but safe harbor

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Penalties for Violation

- Same as the other TILA violation (creditor liability, generally not natural persons)
- Actual damages, plus 2X finance charge (but no less than $400 or more than $4,000)
- Class actions capped at $500,000
- Criminal penalties for willful violation

Reg Z – 4/1/11 – Recap

3 General Rules

- **Rule 1** - No comp to loan officer from anyone else, if consumer pays loan officer directly
- **Rule 2** - If anyone else pays loan officer, no payment from consumer, or based on terms/conditions of loan – exceptions
- **Rule 3** - If anyone else pays loan officer, no steering consumer to close loan not in consumer's interest

Reg Z – 4/1/11 – Recap

4 Examples of Applicability

- **Situation One:** - Loan officer who is broker compensated by Wholesaler (Plus YSP Issue)
- **Situation Two:** Owner of brokerage company.
- **Situation Three:** Producing/Non-Producing Manager of a Lender
- What about **seller contributions** to closing costs?

Dodd-Frank LO Comp Rule

Coming Soon

DFA Rule – In Brief

- Similar, but different
- MO (Mortgage Originator) definition broader
- Prohibited MO comp methods:
  - No MO comp from any source based on loan terms, other than loan amount
  - MO comp from creditor or consumer, but not both
  - YSP prohibited for LO comp

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DFA Rule – In Brief

- Allowed MO comp:
  - MO comp based on volume of loans during set period
  - Discount points, to obtain lower rate – can finance points
- Secondary market transactions not covered

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DFA Rule – In Brief

- No steering:
  - Applies to MO and creditor
  - Cannot steer from qualified loan, to loan that consumer lacks ability to repay, or predatory loan (undefined)

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DFA Rule – Major Differences

- Mortgage Originator definition broader
- If non-consumer pays MO, no consumer-direct payment AND no consumer upfront payments (e.g., discount points, origination points/fees), unless agency waives rule
- Steering prohibitions broader: apply to creditors AND no safe harbor
- Loan term/condition prohibition broader: Applies even if consumer pays directly
- Increased penalties, MO liability, longer S/L, state AGs

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DFA RULE

MO Comp Summary

- Coming soon, but not yet
- More restrictive
- Second round of changes

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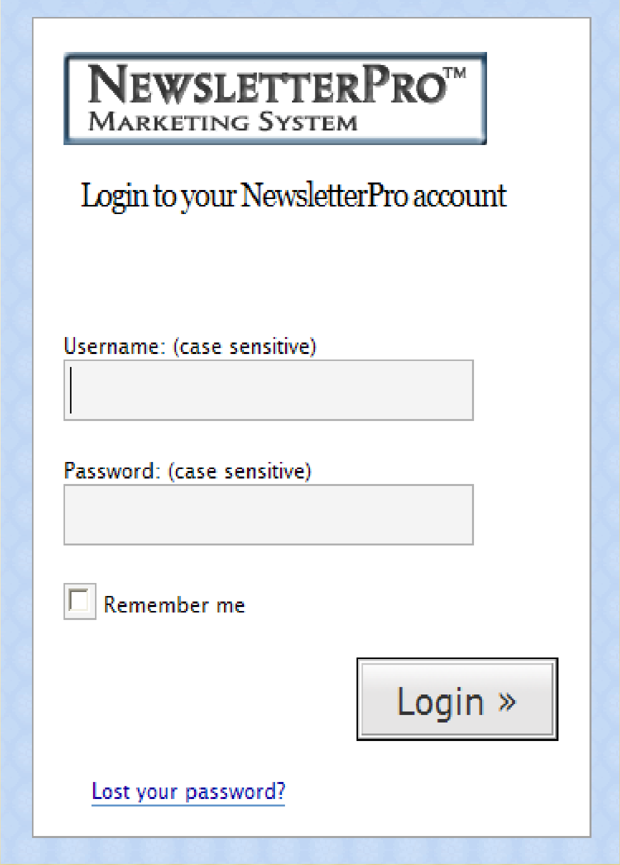

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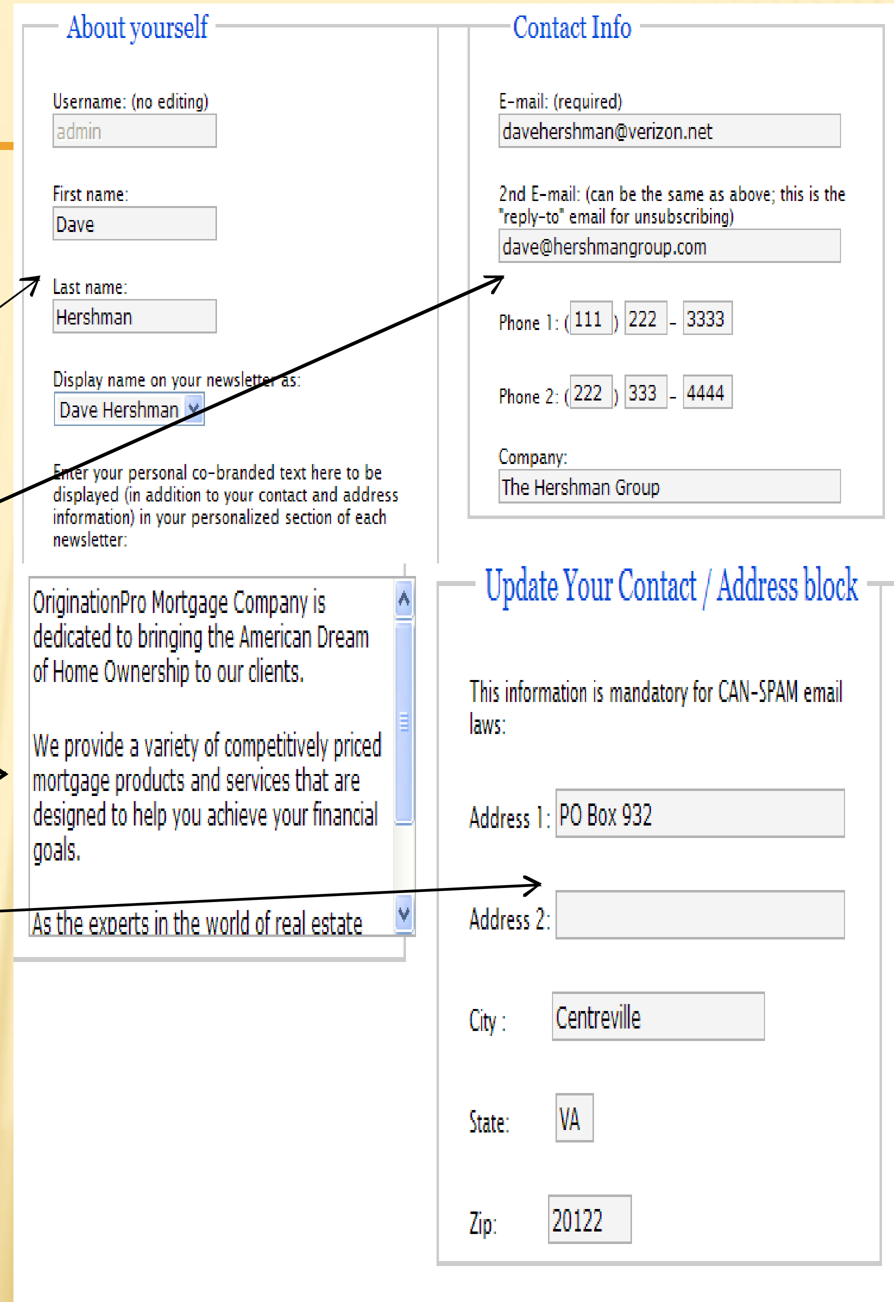

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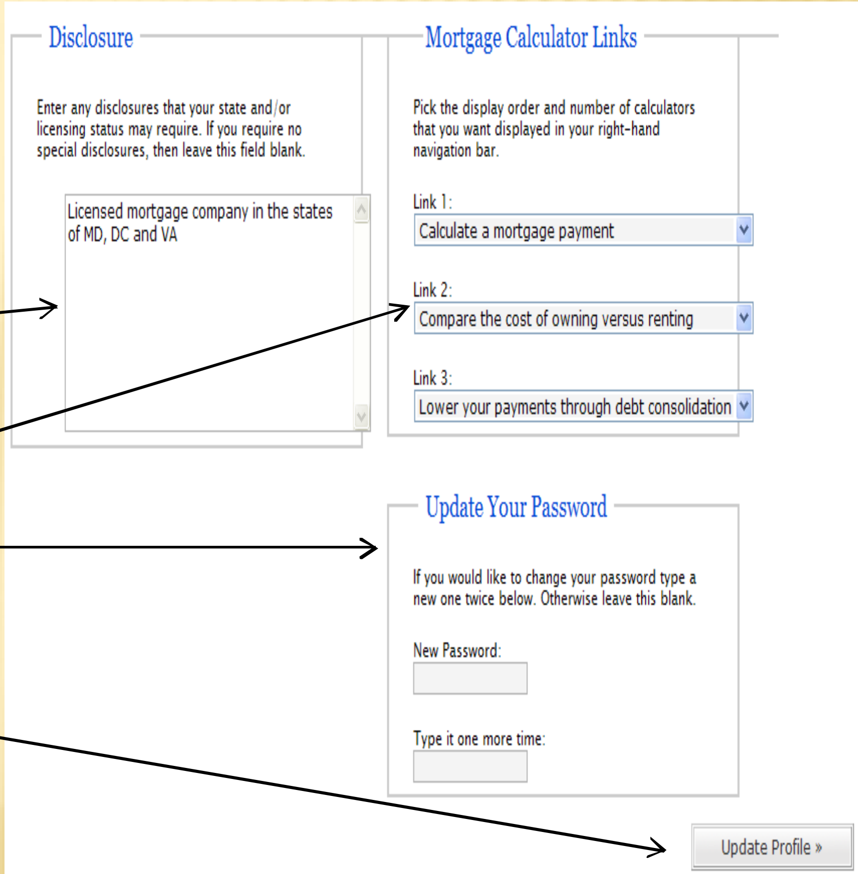

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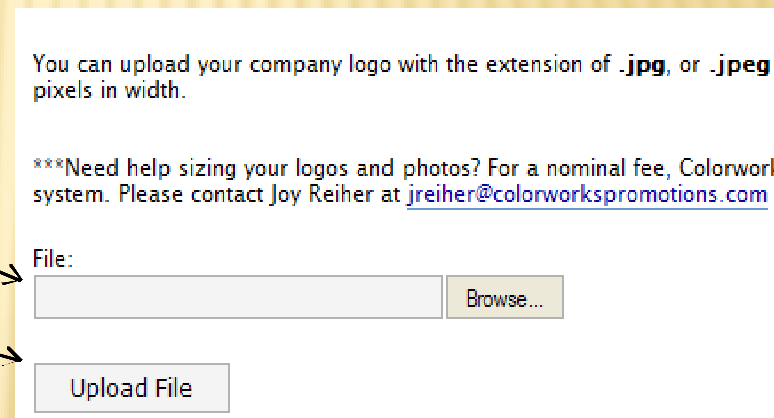

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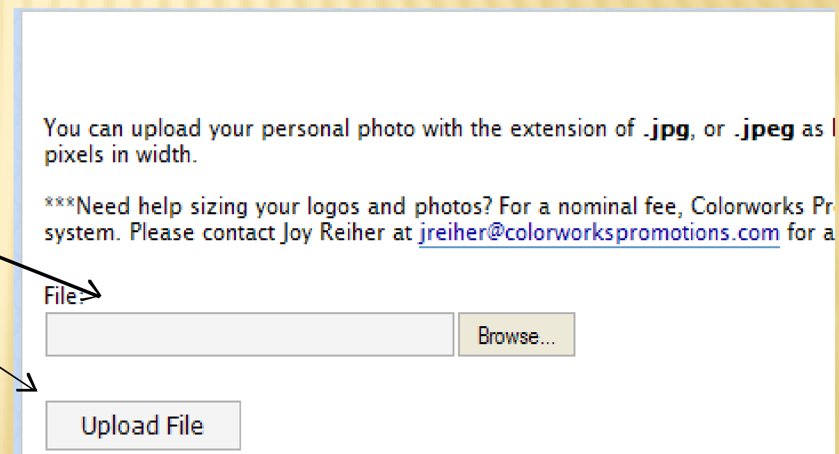

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REAL ESTATE REPORT

May 19, 2009

ECONOMIC COMMENTARY

Has the market gotten ahead of itself?

The stock market has rallied for over two months, oil prices have risen and long-term rates have gone up as well. It is not surprising that the markets have paused to take a breather. Yes, the reports were fairly negative this past week with higher jobless claims and slower than expected retail sales. Even the good news, slow consumer inflation, is indicative of a slower economy. But the markets have been reacting positively through a lot of negative economic news. Why pause now?

It would not be out of the question to view this period as a breather or period of consolidation. The markets are not likely to turn back down unless there are some really surprising negative statistics. We don't rule that out. For now, the breather and lower rates are a great opportunity for homeowners and consumers to take advantage of what might be the last chance to obtain the lowest rates of our generation. At this point rates on home loans have stayed steady despite higher rates on Treasuries and that can't last forever.

WEEKLY INTEREST RATE OVERVIEW

The Markets. Rates on home loans were fairly stable last week. Freddie Mac announced that for the week ending May 14, 30-year fixed rates averaged 4.86%, up slightly from 4.84% the week before. The average for 15-year rose slightly to 4.52%. Adjustables were lower with the average for one-year adjustables decreasing slightly to 4.71% and five-year adjustables falling to 4.82%. A year ago 30-year fixed rates were at 6.01%. "Fixed-rate mortgages were little changed this week following the release of April's employment figures," said Frank Nothaft, Freddie Mac vice president and chief economist. "The economy lost 539,000 jobs, less than the monthly job loss of the past five months, and the unemployment rate rose to 8.9 percent. Adjustables, however, fell slightly over the period. Relatively low house prices and rates are clearly helping first-time homebuyers. Housing affordability for the median first-time buyer reached an all-time record high in the first quarter since the NAR index began in 1981. Consequently, first-time homebuyers accounted for half of existing home sales in the first three months of this year, the NAR reported."

Current Indices For Adjustable Rate Mortgages

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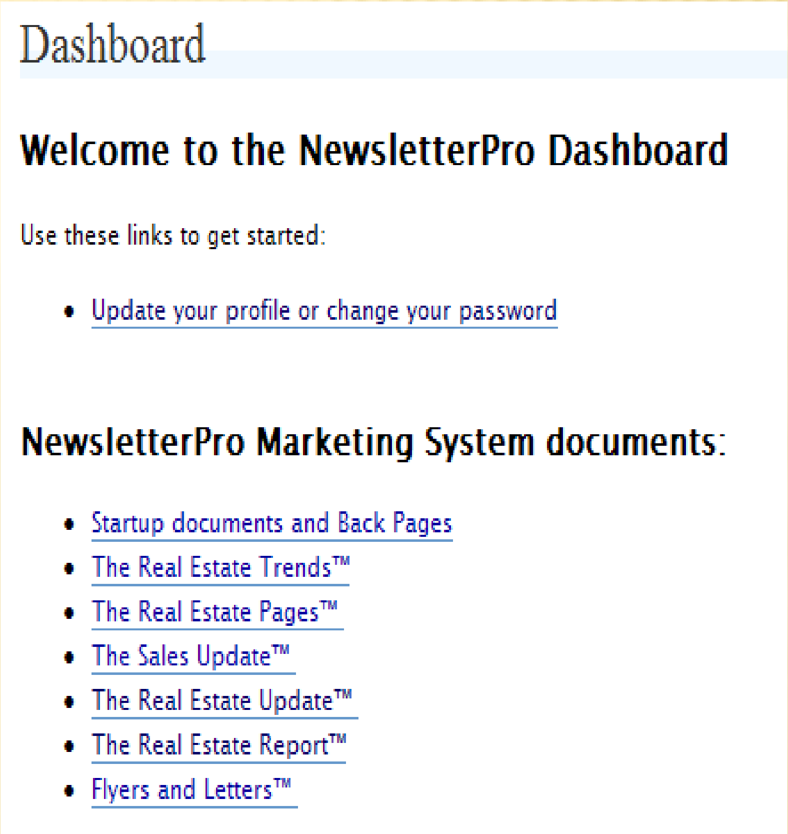

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- Back Pages. These help turn the one-page documents into self-mailers.

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Letter To Prospect

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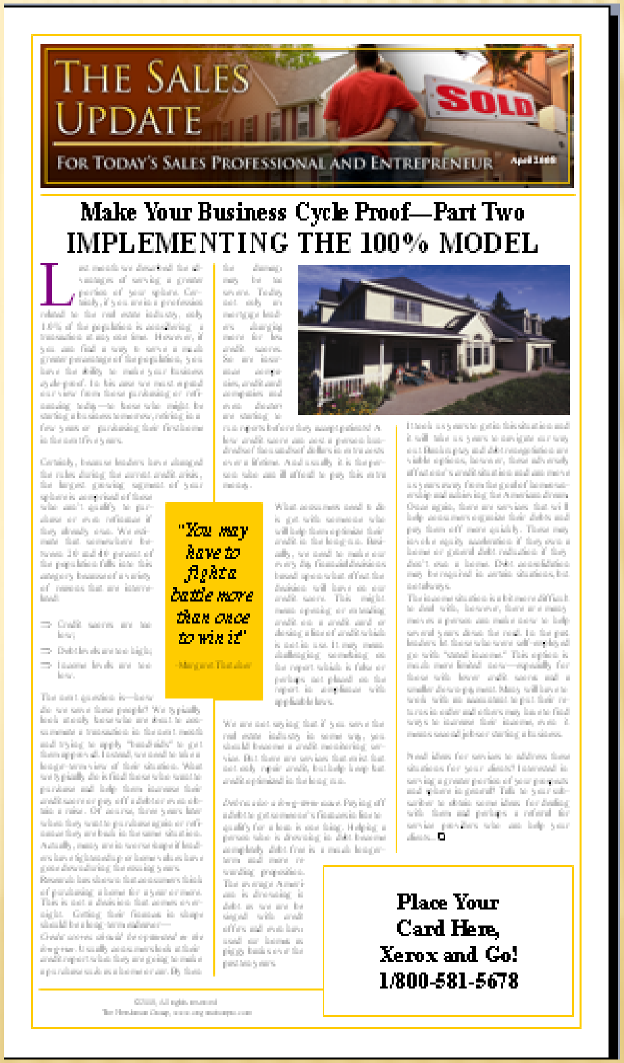

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October 2008

Government To The Rescue!

Just when you think things can't get any wilder, they do. The last month has given a new definition to the term "wild and crazy." What has happened? The government took over the most important housing entities in the nation—Fannie Mae and Freddie Mac. The government also bailed out a major insurer, AIG to the tune of $85 billion dollars. While they were doing that, the Feds chose to let a major financial company, Lehman Brothers, collapse. Meanwhile the stock market's Dow Jones Industrial Average has been going up and down (more down) hundreds of points from day-to-day. Now the government is formulating a plan to purchase distressed mortgages from financial institutions.

What is behind this financial madness? The housing crisis. As home prices go down and foreclosures soar, the mortgages that investors have purchased are becoming worthless. While housing is the major cause, it is also the solution. When home prices stop going down and people start buying again, the markets will stabilize. Actually the crisis will be part of the solution. Interest rates have fallen sharply over the past several weeks as the crisis intensifies. Lower rates translate into increased demand for homes because it makes owning a home more affordable. Coupled with lower home prices, lower rates will help hasten the end of the crisis.

The longer the crisis goes on, the more likely that the housing recovery will be

Come Get Your $7,500!

News continues to be released regarding the tax credit authorized by the recent housing legislation. The government feels that providing an incentive to purchase homes at the present time will help hasten the housing recovery and we agree. Here are some facts regarding the credit.

- First time homebuyers who purchase a principal residence between April 9, 2008 and July 1, 2009 qualify for the tax credit and it is retroactive for buyers who have already closed.

Tax Credit

- The maximum credit is $7500 or 10% of the purchase price if lower than a $75,000 sales price.
- If the home is purchased in 2009, homebuyers can elect to amend 2008 tax returns and claim a tax credit.
- The tax credit is "recaptured" by the IRS, and is an interest-free loan and

Population Projections

to the country's changing racial composition than to the massive scope of the increase. What's clear is that the latest numbers will inevitably give the real estate business a boost.

The Census Bureau is projecting an increase of 135 million people in the U.S., a 44 percent rise, by 2050. That's equivalent to the entire populations of Mexico and Canada moving to the United States. The bureau estimates that this population boom, largely fueled by immigration, will require 52 million new housing units, along with more places for people to shop and work.

The recent housing slump has caused homebuilding to fall significantly below one million units annually, including multi-family units. This means that present home building activities will not be sufficient to meet the needs of future population growth. The longer the housing slump continues, the more acute the shortage in the future…

Did you know…

- *Activity is slowing in the commercial real estate market in response to tightening credit and weak economic growth, according to the National Association of Realtors. In its latest Commercial Real Estate Outlook, the NAR reports that financing problems stemming from the crisis on Wall Street, not a lack of demand, are curbing real estate*

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