LOAN OFFICER COMPENSATION TIPS AND TRENDS:

HOW TO GAIN A COMPETITIVE EDGE WHILE REMAINING COMPLIANT

James W. Brody, Esq.
Chairman of Mortgage Banking Practice Group
JOHNSTON I THOMAS, ATTORNEYS AT LAW, P.C.
415.246.3995 / jbrody@johnstonthomas.com

Updates and Developments in 2018

July 26, 2018

JOHNSTON | THOMAS

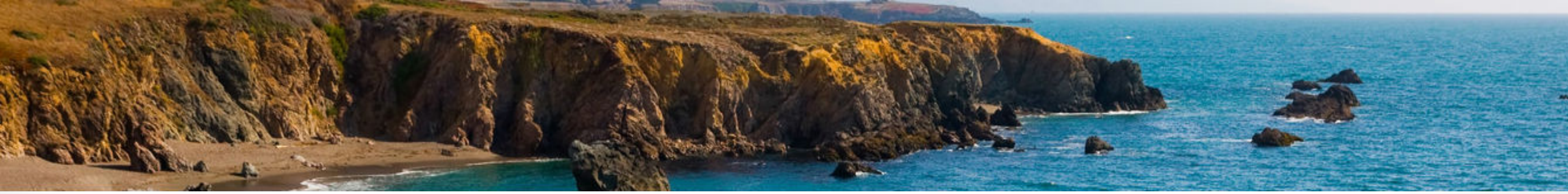
ATTORNEYS AT LAW

James W. Brody, Esq.

Chairman of Mortgage Banking Practice Group

JOHNSTON I THOMAS, ATTORNEYS AT LAW, P.C.

415.246.3995 / jbrody@johnstonthomas.com



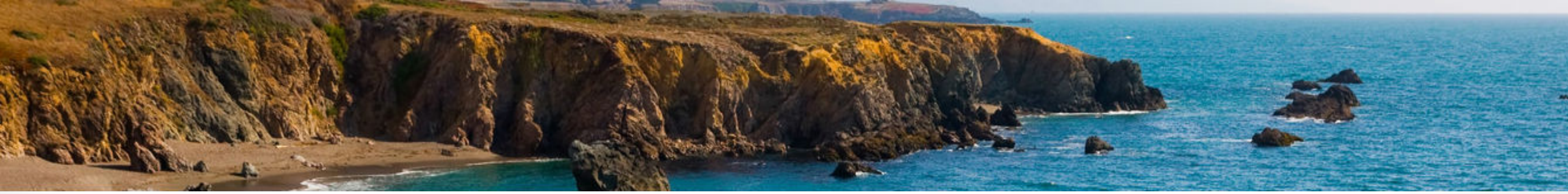
James W. Brody

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

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

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

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



Brief Introduction to
Johnston I Thomas, Attorneys at Law, P.C.

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

The Johnston | Thomas DIFFERENCE

At Johnston | Thomas, you're more than a client — you're a part of our family. We are a multidisciplinary law firm committed to providing clients — both individuals and corporations — with passionate and professional legal representation in the areas of business, real estate, construction, nonprofit, estate planning, trust administration, probate and more. Our law firm is located in the heart of the scenic Sonoma County, with our office in Santa Rosa, California. In addition, we have a nationwide presence with affiliated offices in Portland and New York.

Find out more at: johnstonthomas.com

JOHNSTON | THOMAS

ATTORNEYS AT LAW

OUR SPECIALTIES

ESTATE PLANNING

ESTATE PLANNING

Planning of estates including wills, gifts, wealth preservation, and generation transfers

ELDER LAW

Addressing the diverse and special needs of those individuals that are 65 or older

TRUST ADMINISTRATION

Helping executors and administrators with probate and trust administration issues

PROBATE

Guiding executors and administrators through probate and trust administration

BUSINESS LAW

NONPROFIT LAW

Helping form, govern, and maintain nonprofit corporations to maximize your mission

BUSINESS ENTITIES

Determining the most appropriate entity type that is best suited for your business

CONTRACTS

Helping clients create, understand, or enforce their contracts

SUCCESSION PLANNING

Planning for the succession of the ownership and leadership of your business

REAL ESTATE LAW

MORTGAGE BANKING

Representing clients in both transactional and litigation matters in banking and finance

CONSTRUCTION LAW

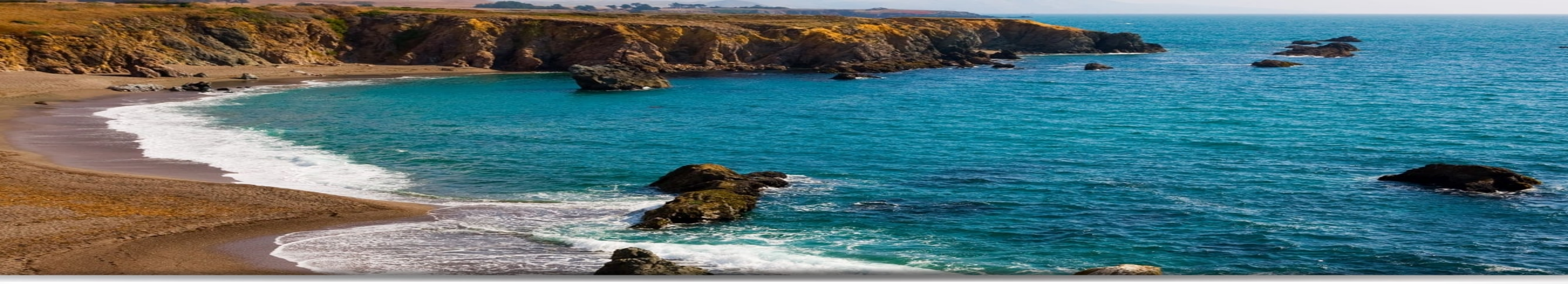
Representing owners, general contractors and subcontractors in transactions and litigation

REAL ESTATE TRANSACTIONS

Assisting you in the transactional process of purchasing or selling property

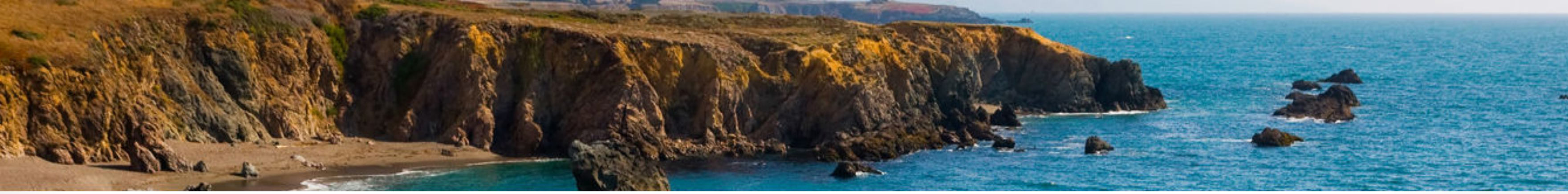
PROPERTY DISPUTES

Representing property owners in a wide range of real property disputes



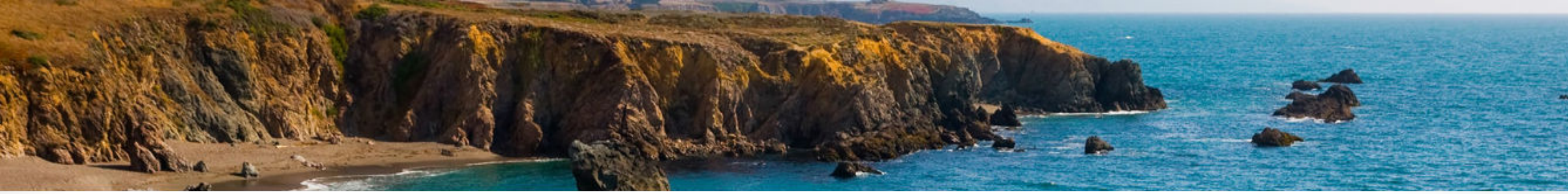
Notice

Important Notice(s): Johnston Thomas Attorney’s at Law (“Johnston Thomas”) makes available the information (the "Information") in this presentation (the “Presentation”) for general informational purposes only. The Information is not intended to constitute, and does not constitute, legal advice. The Information is not intended to constitute, and does not constitute, a solicitation for the formation of an attorney-client relationship. No attorney-client relationship is created through your use of or your receipt of the Information contained within the Presentation. Johnston Thomas accepts clients only in accordance with certain formal procedures, and renders legal advice only after the completion of those procedures, and/or completion and execution of an appropriate retainer agreement.



Webinar Agenda

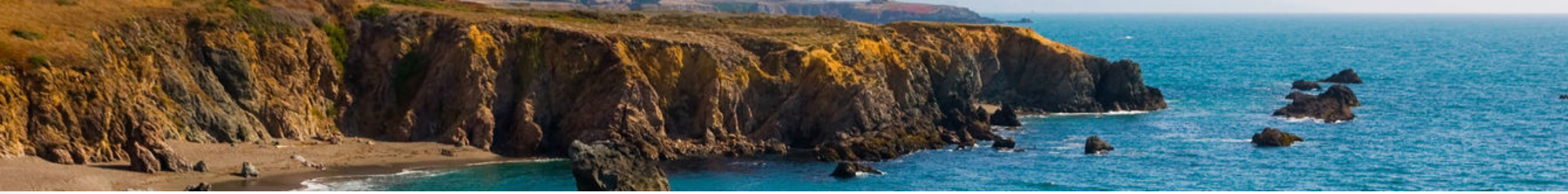
- Stated Purpose of the Rule: Preventing Steering and Protecting the Consumer
- Nuances of the Rule Continue to Trouble Lenders
- Utilizing all Tools Available
- Pooled Compensation
- LOs that Work as a Team Compensation
- "Pick a Plan" Structures
- Can I pay my LO as an Independent Contractor?
- Splitting Comp Between LO's
- Awards of Merchandise, Services, Trips, or Similar Prizes to LOs
- Mistakes by Our LO's are Costing us Money-Can We Hold Originators Responsible for Controlling Costs? Are EPO/EPD Clawbacks Permissible? Loan Originator Paying for Unanticipated Cost Increases
- Quality Loan Factor in LO Comp Plans
- Non-Producing Managers and Sales Executives
- Bonuses and Retirement Plans. Bonuses Based on Volume
- Current LO Comp Regulation and Enforcement
- What about UDAAP?



Stated Purpose of the Rule:

Prevent Steering

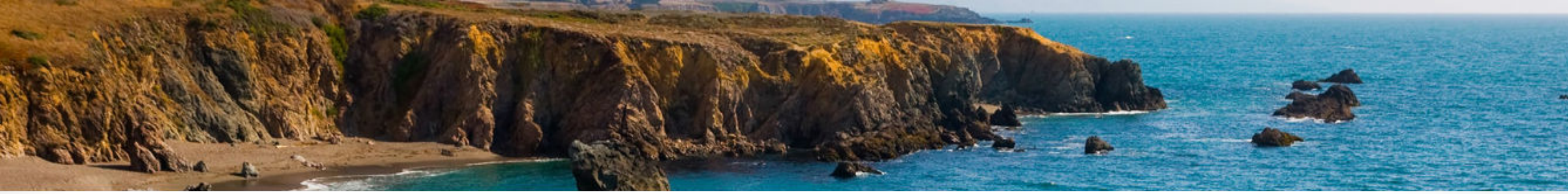
Protect Consumers



Key Elements of the Rule

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

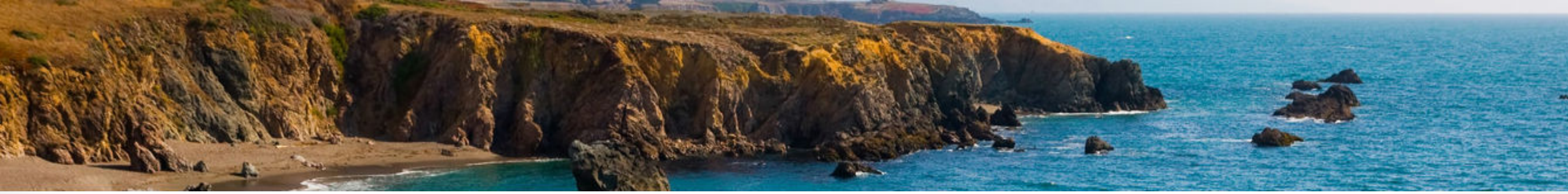
- Prohibits compensation from both the consumer and another person



Utilizing All Tools Available

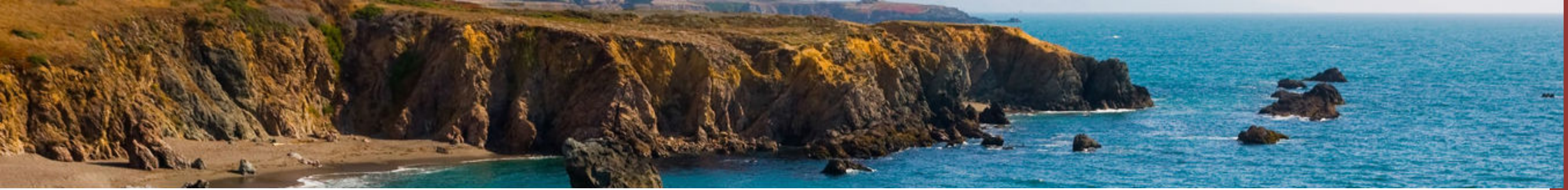
Compensation paid or received according to these “Safe Harbor” methods is not based on transaction terms or proxies for transaction terms:

1. The loan originator’s overall dollar volume (total dollar amount of credit extended or total number of transactions originated), delivered to the creditor.
2. **The long-term performance of the originator’s loans.**
3. An hourly pay rate based on the actual number of hours worked.
4. **Loans made to new customers versus loans to existing customers.**
5. A payment that is fixed in advance for every loan the originator arranges for the creditor.
6. **The percentage of the loan originator’s applications that close.**
7. **The quality of the loan originator’s loan files submitted to the creditor.**



Permissible Comp Structures

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



Permissible Comp Structures (cont.)

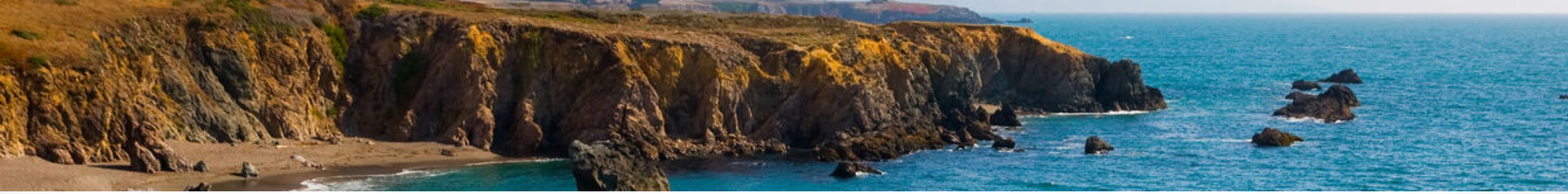
- **Pick a Plan Structures**

Option 1-No Assistant

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

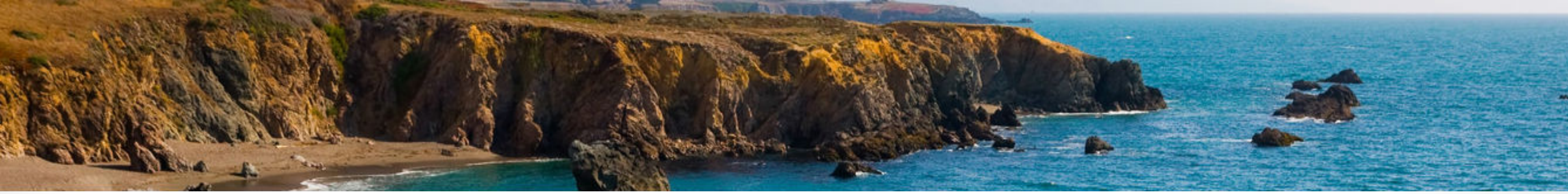
Option 2 – Assistant

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



Permissible Comp Structures (cont.)

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

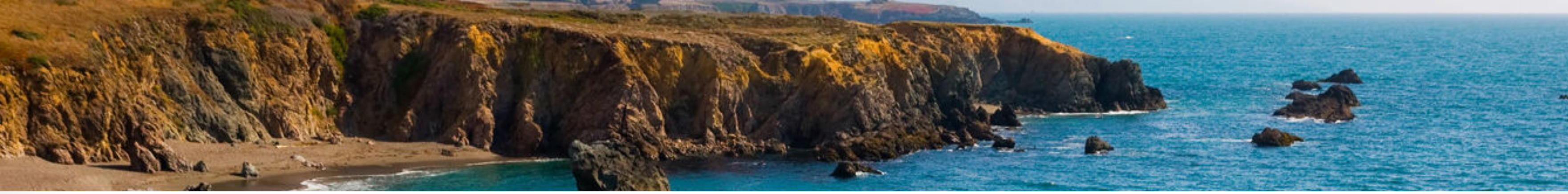


Permissible Comp Structures (cont.)

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

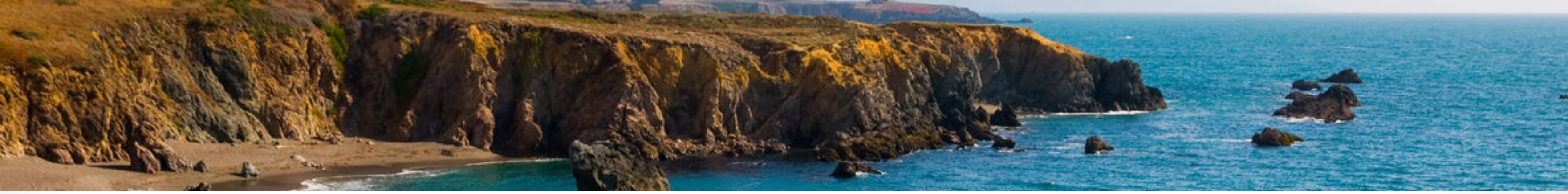
Capped at 10% of LO's total comp for same period	OR	Individual LO was an LO for 10 or fewer transactions during the preceding 12-month period

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



P&L Branch Exercise

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

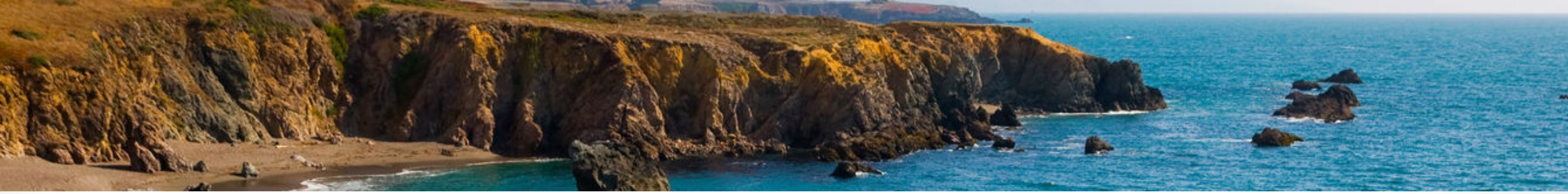


Proxy of a Loan Term

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

EXAMPLES

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



Prohibited Compensation Structures

- **Varying LO Comp by Loan Product**

  Loan Product = Bundle of Terms

- **Compensation Pools**

  Terms of multiple transactions by multiple LOs

- **Point Banks**

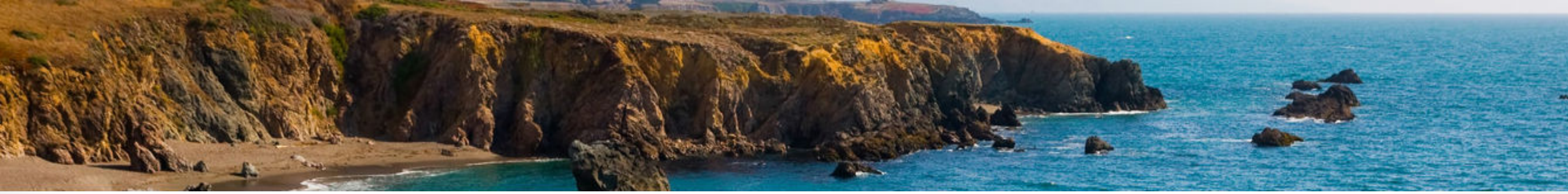
  CFPB: "there should be no circumstances under which point banks are permissible" Rule Preamble

  But: Pay changes can be based on past performance

- **Sliding Scale % (buckets)**

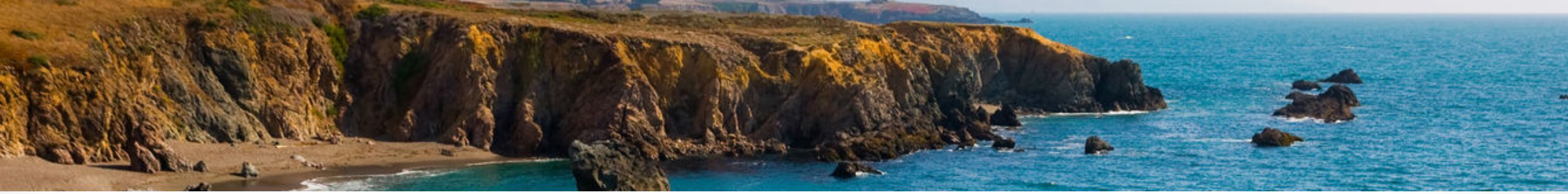
  1% for loans ≥$300K, 2% on $200K-$300K, 3% for loans < $200K

- **Basing LO Comp on Sold vs. Portfolio (PROXY)**



Questionable Practices

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



Questionable Practices (cont.)

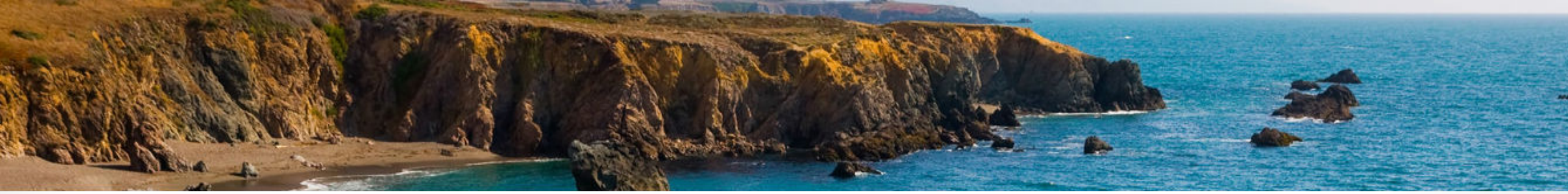
- **Paying an LO as an Independent Contractor**

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

<u>IRS Control Test</u>

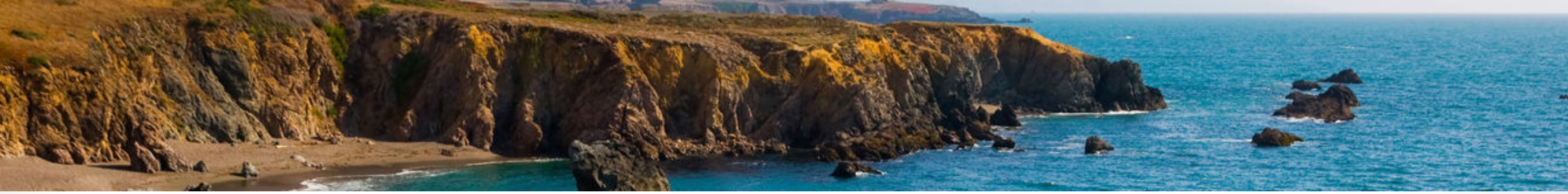
Independent Contractor	Employee
Payer directs result only	Employer directs what and how

Loan Originator ≠ Independent Contractor



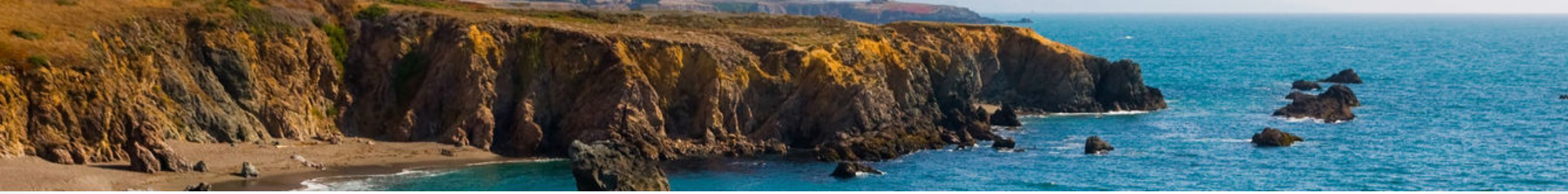
Proceed with Caution

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



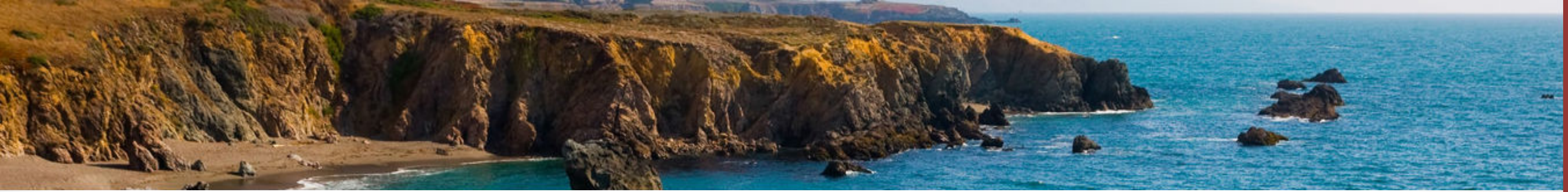
CFPB Enforcement Actions

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



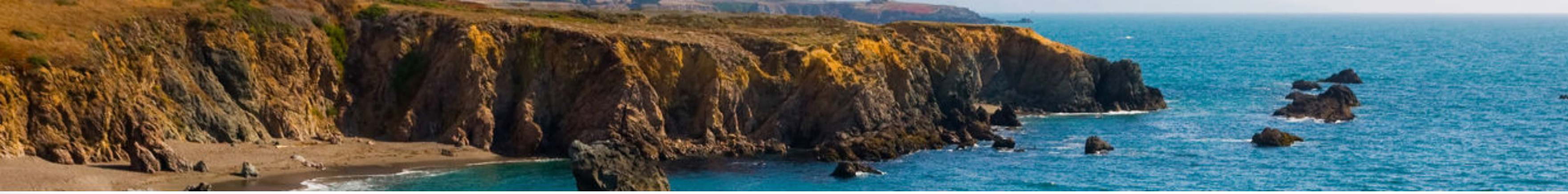
CFPB Enforcement Actions (cont.)

- Jan 2017, Prospect Mortgage LLC
  - Desk licensing agreements not at FMV
  - Lead fee agreements
  - Paid referrals disguised as MSAs
  - Required preapprovals
  - Lender written into listings
  - Lender paid real estate ads
  - **RESPA kickback violations**



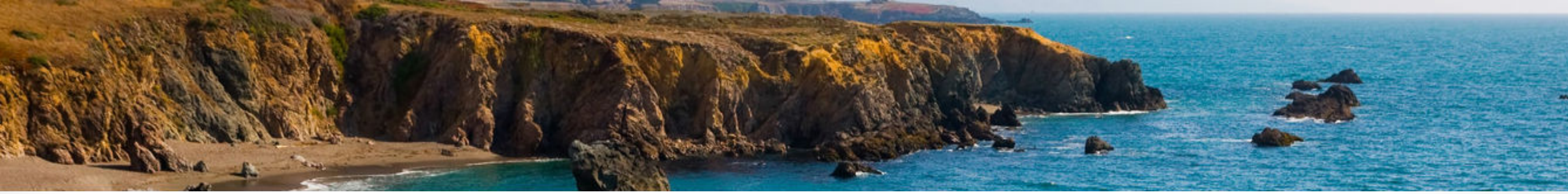
What About UDAAP ?

- Unfair Deceptive Abusive Acts or Practices
  - Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd- Frank Act), all covered persons or service providers are legally required to refrain from committing unfair, deceptive, or abusive acts or practices (collectively, UDAAPs) in violation of the Act.
  - Often UDAAP is a tool the CFPB uses when it finds an unsavory practice that does not fit neatly into its other rules.



Competitive Dis-Advantage

- Against Lenders that Bend the Rules
  - Educate your staff and stay abreast of enforcement actions (it helps when the staff understands why these rules exist and can then buy in to idea of compliance)
  - Create and actually implement policy and procedures
  - Provide transparency on compensation process
  - Self audit
  - Measure more – and then compensate based on those measurements
    - Quality Submissions
    - Compliance benchmarks
    - Any objective item other than profit



Thank You

Contact Information:

James W. Brody, Esq.,
Mortgage Banking Practice Chair
Johnston Thomas, Attorneys at Law, P.C.
1400 North Dutton Ave, Ste 21
Santa Rosa, CA 95401
Telephone: (415) 246-3995
Email: JBrody@johnstonthomas.com