



Be Cautious with Bonuses to Bank Personnel Involved With Mortgage Lending

By Scott Meacham

The Independent Banker's Association of Texas (IBAT) has issued an alert with respect to bonuses. According to IBAT, both the FDIC in field examinations as well as senior counsel at the Consumer Financial Protection Bureau (CFPB) are construing the prohibited payments provision of §226.36(d) of Reg Z to prohibit incentive compensation based on bank performance if that performance includes interest on residential mortgages.

Although this sounds ridiculous, here is the rationale. Section 226.36(d) (1)(i) provides that "in connection with a consumer credit transaction secured by a dwelling, no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction's terms or conditions."

Furthermore, "loan originator" is defined very broadly in §226.36(a) to include a person who "arranges, negotiates, or otherwise obtains an extension of consumer credit for another person." Employees of a creditor are considered loan originators if they otherwise meet the definition. Therefore, the employees of the typical bank that makes or originate home mortgages will be considered a "loan originator" if they arrange, negotiate or otherwise obtain the mortgage. Clearly this definition would include the loan officer. A more interesting question arises in the situation where the customer interested in a home loan drops in to see the bank president or other senior officer and the bank officer then escorts the customer to the mortgage loan officer. Does this make the bank officer an "arranger"?

Hopefully, as can be seen from the hypothetical but all too often occurring situation above, the regulators could construe "loan originator" broadly to include many different employees in the bank. The next question then is whether the employee is receiving prohibited compensation. Traditionally, it was believed that §226.36 only prevented commission being paid based on the amount the bank earned in relation to the loan. The FDIC and CFPB, however, seem to be taking a much broader approach and are contending that any incentive tied to bank profitability is prohibited because it includes as a component earnings from residential mortgages. This seems to ignore the "in connection with" language in §226.36(d)(1)(i) but appears to be the position at least these two regulators are taking.

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Until this interpretation can be challenged, banks should proceed cautiously with respect to earnings based incentives paid to any bank personnel who could arguably fall under the definition of "loan originator." It would be wise to consider subtracting any income realized from home mortgage lending from the incentive calculation or to pay incentives based on a fixed percentage of the amount of residential mortgage loans made and/or originated which is specifically allowed under §226.36(d)(1)(ii).

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