California MORTGAGE FINANCE NEWS

Winter 2018

LIBOR REPLACED BY SOFR
So Far, So Good?
SEE PAGE 19

49 Shades of Grey

What the Increase in State-Level Enforcement Means for CA Lenders

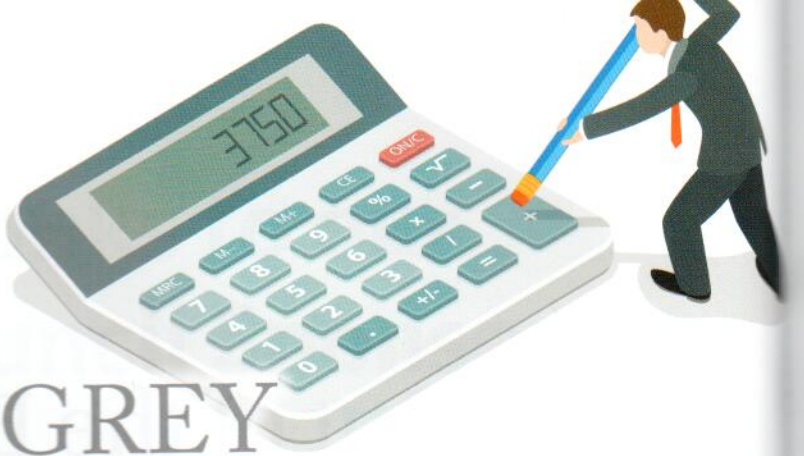
SEE PAGE 12

IN FOCUS:
Compliance/
Regulation

PRSRT STD
U.S. POSTAGE
PAID
PERMIT NO. 316
SACRAMENTO, CA

Visit us at www.cmba.com

A publication of
CaliforniaMBA
Advocacy. Education. Connection.



49 SHADES OF GREY

What the Increase in State-Level Enforcement Means for CA Lenders

by
MICHAEL BARONE,
Esq., Executive Director of Compliance, MQMR

and
MARIE O'BRIEN,
Esq., Director of Compliance, MQMR

With the Consumer Financial Protection Bureau (CFPB) taking a seemingly less aggressive approach to enforcement, many lenders might assume that they, too, can back off of compliance. This is a fallacy.

State regulatory agencies have begun to fill the enforcement void, and the California Department of Business Oversight (DBO) is no exception. As such, lenders can ill afford to take a more relaxed stance on compliance. Given two areas that often receive intense scrutiny by California regulators – marketing and labor/compensation – the following are two "grey area" scenarios to which lenders need to pay special attention.

Of course, what follows does not constitute legal advice, and it is always recommended that lenders seek specific counsel on any matters regarding compliance.

BRANCH MARKETING

In the current bear market, many lenders are stepping up their marketing efforts in order to attract potential homebuyers and appease loan originator marketing requests. This can get tricky at the branch level, especially when a branch seeks to promote itself using a non-branded name. For example, many branches refer to themselves as "The ___ Team."

If the team name has been approved as a DBA of the parent lender by the proper state regulatory agency (in this case the California DBO), then the branch is free to market themselves solely under the team name without referencing the parent company because consumers can look up all relevant information on the team and its parent company via the Nationwide Multistate Licensing System & Registry (NMLS).

However, if the team name has not been approved by the proper state regulatory agency and the branch issues marketing materials under just the team name, the branch and lender would likely face problems with regulators, as in this case, there would be no indication of who the licensee is and would be viewed as being deceptive to the recipient of the marketing. That's a pretty clear cut violation.

The grey area in this scenario is if a branch markets itself under the team name but also makes reference to the parent organization, which makes it clear who the licensee is. There's nothing in California law that strictly prohibits this activity. However, the increase in enforcement at the state level indicates that grey areas such as these could come under greater scrutiny, particularly since other banking

...Cover Story continued on page 13

Cover Story continued from page 12...

departments have begun requiring team names to be registered as trade names. Therefore, lenders should seek clarity on this marketing practice to ensure they are meeting both the letter and the spirit of California law.

LO COMPENSATION

While lenders are grappling with declining volume and the rising cost to originate, the industry conversation has also begun to turn towards the topic of loan originator (LO) compensation, and lenders are seeking creative solutions to address what is easily their largest expense per loan. Of course, these solutions must fit into the parameters of the current LO Comp rules, although there are still grey areas to be found.

For example, the current LO Comp rules prohibit lenders from compensating LOs differently based on product type, but the regulation only covers compensation, not necessarily the LO's employee status (i.e. 1099 vs W2). As such, many lenders have begun exploring the boundaries of how they classify LOs' employment status.

The Federal Housing Administration (FHA) prohibits lenders from allowing anyone other than W-2-paid LOs to originate FHA-insured loans. Thus, some lenders have begun paying LOs as W-2 employees on just their FHA production and as 1099 independent contractors on all other conventional loans.

While it is certainly true that FHA loans are different from other types of conventional loans and require the LO to perform different actions, loan type alone may not provide enough differentiation to justify the separate classifications solely on loan type, as the lender must be able to provide substantial evidence to support its reasoning for paying an LO as a 1099 contractor for conventional loans and as a W2 employee for FHA loans. Not only could this type of activity draw the attention of the Internal Revenue Service (IRS), but given California regulators' persistent interest in issues related to labor and compensation, it would not be outside the realm of possibility for this activity to come under scrutiny at the state level as well.

While the authors are not aware of any specific enforcement actions taken against a lender in California for this particular practice, there are enough questions surrounding this type of activity that it bears further investigation to ensure it does not run afoul of regulators' interpretations of relevant law.

In addition, it bears repeating that the content outlined above is intended to serve as "food for thought" and should, in no way, be interpreted or viewed as legal advice. As state regulators step up enforcement in the absence of more strenuous oversight by the CFPB, "grey areas" such as the ones outlined above are going to come under more intense scrutiny, and in a state such as California that has a track record of being historically pro-consumer, lenders cannot bank on regulators siding with them when evaluating these "grey areas" activities for potential consumer harm. Thus, lenders must seek clarity on these and all other "grey areas" to ensure they remain on the right side of regulators.