MLO Compensation at Community Banks
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The Dodd-Frank Act brought the banking world a slew of new requirements, including changes to Regulation Z that limit the amounts and types of compensation that can be paid to mortgage loan originators (MLOs).

As most community banks do not necessarily pay loan originators on a commission basis, but rather salary those employees, many may have assumed that the rules did not apply to them. Some of those bankers are learning a hard lesson from their regulators that the rules may apply to salaried employees, particularly those that receive periodic bonuses as part of their total compensation.

The compensation rules are found at 12 CFR 1026.36-Prohibited acts or practices and certain requirements for credit secured by a dwelling. Specifically, this section defines compensation to include salaries, commissions, and any financial or similar incentive. Section 36(d) is entitled Prohibited payments to loan originators. The rules discuss three different types of compensation, as detailed below.

The first type of compensation is based on something other than a term of the transaction, or the terms of multiple transactions for a single MLO. A term of transaction does not include the loan amount, provided that the compensation is based on a fixed percentage of the amount of credit extended, possibly subject to minimums and maximums.

The second type of compensation includes contributions to a defined contribution plan that is a designated tax-advantaged plan or benefit under a defined benefit plan that is a designated tax-advantaged plan. These contributions must also be based on something other than a term of the transaction.

The third type of compensation falls under a "non-deferred, profits-based compensation plan," such as periodic bonuses. These types of payments are permissible if the compensation is not, directly or indirectly, based on the term of the originator's transactions that are subject to the rules, AND the compensation paid to an individual MLO does not, in the aggregate, exceed 10 percent of the individual MLO's total compensation corresponding to the time period for which the payment is based. There is also a caveat allowing bonuses for MLOs who consummate 10 or fewer deals a year.

As used in this rule, a non-deferred, profits-based compensation plan is any compensation arrangement where an individual loan originator may be paid variable, additional compensation based in whole or in part on the mortgage-related business profits of the person paying the compensation. This also includes affiliate income in certain instances. In short, if you pay bonuses to any MLO that are based on the profitability of the mortgage portfolio, in whole or in part, the bonuses are limited to 10% of the employee's total compensation.

For example, assume your senior mortgage lender is paid a base salary of $85,000/year, and is eligible for the bank's total bonus pool paid out at year end. When the individual bonuses are calculated, based on the overall profitability of the bank, the officer receives a bonus of $10,000 from the bonus pool for all employees. This brings the officer's total compensation to $95,000, which means the bonus represents 10.52% of the MLO's total compensation, and is therefore illegal under this section of Regulation Z. While your senior mortgage lender's compensation might be based on several factors that have nothing to do with the mortgage loan portfolio, the bonus will still be deemed illegal.

We are aware of banks that have been caught completely off guard by this section of the rules. We recommend that all community banks carefully review the compensation paid to any registered MLOs to ensure that bonuses paid do not exceed the limitations, and that your future examinations do not garner unnecessary violations of law.