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Mortgage Lenders Err on Side of Caution with Broker Fees Under QM

By Kate Berry
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It's the mortgage industry equivalent of driving five miles below the speed limit to avoid detection by Smokey's radar.

Some residential lenders are taking an ultra-conservative approach to originating brokered loans by imposing tougher requirements than the regulations to ensure compliance.

Wholesale lenders, which fund loans through independent mortgage brokers, are setting a 2.7% ceiling on compensation paid to these third-party originators, below the Consumer Financial Protection Bureau's 3% cap on points and fees. They are doing so to avoid any questions that their loans are considered qualified mortgages and receive extra legal protection.

The practice adds yet another "overlay" above and beyond government guidelines. Other lender overlays, such as higher FICO score minimums than Fannie Mae and Freddie Mac require, have shut out otherwise qualified borrowers. And some say this one is having the same effect.

"It is an overlay by any other name," says Brian Hale, the CEO of Stearns Lending in Santa Ana, Calif. "The fear of QM non-compliance is hindering the ability to do deals."

Still, many lenders have said the CFPB's sweeping set of mortgage regulations has not necessarily caused a credit crunch for borrowers, even though lending is down significantly this year for a variety of reasons.

Some wholesale lenders say they have adopted a 2.75% cap on broker compensation because there are other charges that fall under the 3% cap. The additional 25 basis points are need to cover underwriting and processing fees, some title charges, and closing or other administrative costs included in the cap.
A 2.75% cap on broker compensation "makes sense," says Kevin Marconi, the chief operating officer at United Fidelity Funding, a wholesaler in Kansas City, Mo.
"It's legitimate space which is required for legitimate expenses incurred by the lender and title company," Marconi says. "The reason for this is because broker compensation is not the only component of the points and fees test in QM. So based on the average loan size for the region, it makes sense to allow a small remaining percentage for these other fees which are charged."

To meet the definition of a qualified mortgage, which gives the originator a safe harbor from litigation, the cap on points and fees is 3% of the total loan amount. The CFPB did acknowledge that lower loan amounts would require different caps though all loans over $100,000 have the 3% cap.

Lenders have lobbied the CFPB for the right to "cure a loan," and still keep QM status, if it is discovered later that a loan exceeds the 3% points and fees cap. The CFPB is seeking input on where it can amend its rules and may allow more flexibility to lenders.

Some lenders say that setting a stricter threshold has no impact on whether borrowers qualify for a home loan.

"This has absolutely nothing to do with shutting out borrowers," says Logan Mohtashami, a senior loan officer at AMC Lending in Irvine, Calif. "It doesn't impact demand. It puts a strain on the system to be efficient. Housing is soft because of people don't make enough money and incomes are weak, not because pay to the broker is 2.75% and not 3%."

But Hale at Stearns argues says that any self-imposes restrictions will ultimately mean some loans don't get made, hurting borrowers.

"Many lenders are staying inside the line to assure compliance, and absent the right to cure you have a more conservative structure, which takes credit availability out of the market," Hale says. "If you have a broad segment of the industry operating in a more than required conservative manner, you by definition reduce the available credit."

Many lenders use technology to take the guess work out of the calculations. But compliance costs are eating into lender profits. Stearns had a team of 40 people who met for 91 straight days prior to the CFPB's mortgage rules going into effect on Jan. 10, to test and solve for potential problems.

Carl Markman, director of national sales at Real Estate Mortgage Network, a wholesale lender in Iselin, N.J., says 5% to 10% of incoming loan files are denied because of the points and fees test.

"It's very expensive to review everything with pre- and post-closing quality control audits," says Markman. "We have several full time people just on compliance and now basically everyone touches compliance."

Mohtashami says he shakes his head in wonder at the lengths lenders have to go through.

"We're preparing a loan's paperwork as if it was enough to go to court and Johnnie Cochran is going to rip it apart," he says, referring to O.J. Simpson's former defense lawyer. "The biggest thing I'm concerned about on any transaction is getting the paperwork right. We spend a lot of time doing useless things, getting conditions or stuff that doesn't make any sense, and the time we have to spend on paperwork is useless and not productive. We need to stop wasting our time with things that have nothing to do with the capacity to own the debt of housing."